FOREIGN BARRIERS TO U.S. TRADE

HEARING

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AND MONETARY POLICY

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PART I—SERVICE EXPORTS

MONDAY, NOVEMBER 9, 1981

U.S. SENATE, COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS, SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY,
Washington, D.C.

The subcommittee met at 10:05 a.m., in room 5302, Dirksen Senate Office Building, Senator John Heinz (chairman of the subcommittee) presiding.

Present: Senators Heinz and Proxmire.

OPENING STATEMENT OF SENATOR HEINZ

Senator HEINZ. We are here today to discuss protectionism. One often reads in the press that our No. 1 trade problem is growing American protectionism. In fact, I believe our No. 1 problem is the protectionism practiced by others, both by our developed and less developed trading partners, in the form of nontariff measures, subsidies, performance requirements, and other such trade-distorting practices.

These activities are growing, and they allow nations to avoid facing their real economic problems. But more importantly, such trade-distorting practices rob U.S. exporters of markets that they would normally capture through their comparative advantages. Foreign protectionism is robbing America of badly needed capital and jobs.

As I see it, we have to pursue two objectives for our own economic well-being and that of the whole world: First, that of free market access; second, that of reciprocity.

Unfortunately, these twin goals are not going to be achieved simply by talking about them, nor are we likely to get very far simply by setting a good example. I believe that we have to work very hard to reverse the trend of growing world protectionism.

I would prefer to see agreements negotiated that do this, but unilateral action may be necessary, as, for example, with the enactment of mirror image legislation to enforce reciprocity. I believe both the American public and the Reagan administration must fully understand the size and scope of the protectionism rampant in the world.

The next step, then, would be to give the issue high priority on our negotiating agenda. We must convince our trading partners of our seriousness. That is the purpose of this series of hearings: To lay out for the record the extent of protectionist barriers to our exports and therefore, to give our negotiators additional ammunition to combat them.

Today we will have the first in a series of hearings on foreign barriers to U.S. trade. To begin with, we will look at the services industries which have been encountering what seems to be an increasing degree of discrimination in recent years.

We will be focusing on data processing, banking, and insurance. But clearly the problem of unfair and discriminatory practices extends across the entire gamut of U.S. service exports. The United States is currently a highly successful service-exporting economy. We have a premier position in service exports, which has grown dramatically during the 1970's—even faster than the overall growth of U.S. exports, which has been quite substantial.

Using current account data, visible receipts from services and investments increased almost fivefold during the last decade—from $20 billion to $94 billion in 1979. Without those receipts and without the earning power of our service exports, our current account would be $27 billion in deficit, instead of a modest $100 million in surplus for 1980.

Nevertheless, our success should give us no cause to relax, both with LCD competitors such as Mexico, and such highly sophisticated developed trading nations as France and Canada. They practice highly protectionistic and nationalistic policies. The worldwide trend is clearly toward more protectionism, not toward a freer, more open trading regime.

Congress recognized this as a potentially damaging problem 7 years ago when it established a mandate in the Trade Act of 1974 for the negotiation of international agreements limiting nontariff barriers to trade and services. During the multilateral trade negotiations the services trade issue proved too difficult to address; but the Trade Agreement Act of 1979 did make clear, through one of the changes we suggested in the Finance Committee, that services as well as goods are intended within the coverage of section 301.

The International Banking Act of 1978, which emanated from this committee, also contained an amendment calling for a study of foreign treatment of U.S. banks abroad.

So, the mandate and at least some of the tools are there. The question is: Where do we go from here?

Today I have asked our witnesses to give case histories and examples of foreign protectionist actions, and to suggest possible solutions.

GATT ministerial talks take place next year, and that is one place to raise the issue, but most consider the time frame for successful negotiations on the multilateral level to be mid-decade. I don't think that we can wait that long; we're going to have to find much more immediate opportunities for negotiation.

If we allow ourselves to relax, we may wake up some day in the not too distant future to find the lucrative markets closed to our most competitive service industries.

With these points in mind, before I turn to our first witness, Ambassador Bill Brock, who is here to explain the administration's service export policy and its negotiating strategy on this issue, I'd like to call on my distinguished ranking member of this subcommittee, Senator Proxmire.

OPENING STATMENT OF SENATOR PROXMIRE

Senator **Proxmire**. Thank you, Mr. Chairman.

First, I want to congratulate you on holding these hearings. I think it's most desirable that we have hearings on protectionism. We have to look at our own weaknesses in that direction, as well as the problems on the part of our trading partners abroad.

At this time in this prospective, it's hard for me to think of a subject that's more appropriate for this subcommittee to get into. After all, our No. 1 economic problem still is inflation. While inflation has moderated a little bit recently, it's a very, very serious problem, and one way that we can overcome inflation is to have freer trade and worldwide competition, and stress vigorous competition.

So, I think that this hearing is most appropriate in that sense. I'm delighted to hear the chairman put the emphasis on doing our best to overcome barriers to free trade and protectionism abroad.

The International Banking Act laid down the principles of treating foreign bankers in this country on an equal basis. That is national treatment. And we haven't gotten reciprocity in that respect, especially for banking abroad. I think that undoubtedly there are other areas where this is also the case.

At any rate, there's more than a mote in our trading partners' eyes, and there is certainly maybe not a beam in our own eyes, but—again, congratulations to you, Mr. Chairman, for holding these hearings. I'm looking forward to them, and I want to congratulate you, too, on the very high quality of the witnesses that you are bringing before us today.

Senator **Heinz**. Senator Proxmire, thank you very much.

Ambassador Brock, please proceed.

We're glad to have you here. We hope that you—and I expect you will—do a very good job of laying the groundwork in this hearing today. We hope in the very near future to schedule a hearing on merchandise exports, but trade in services has proved to be the most intractible and difficult problem. So, it's very appropriate that you are here on this occasion.

STATEMENT OF WILLIAM BROCK, U.S. TRADE REPRESENTATIVE

Mr. **Brock**. I thank you for holding hearings and drawing attention to this subject, Mr. Chairman.

You have, as your colleague has mentioned, a remarkably good panel. I will try, under the circumstances, to do two things then:

First, to limit my own remarks to a more abbreviated form than that which I have written, and which I will submit for the record;

Second, to talk more about the negotiating strategy we are undertaking, in terms of our basic studies, rather than to concentrate on the examples, which some of the later witnesses will have in full measure. And they are, frankly, more skilled, because they have to face them on a daily basis.

Let me just say at the outset that it is simply irrational to think that we can have a world trading system which allows for a liberalized trading process and for expanding trade in goods, unless we accomplish within that system trade in services. It's irrational to think you can trade goods unless you have the services available to facilitate the trade—banking, insurance, shipping, construction, engineering, data flows.

All of those are intrinsic to the basic trade process, and it simply does not make sense to suggest that we can do ourselves any favors by limiting the international code of conduct to those goods which are tangible in nature.

BARRIERS IN TRADE SERVICES

We don't have any rules governing trade in services in the international marketplace. That's the sum and substance of the case.

Services now comprise 25 percent or more of trade, and are growing at the rate of twice that of traded goods. Just to give you the quick numbers—and I won't spend any great time on this—but: 65 percent of our GNP is in services; 71 percent of our nonagricultural work force are employed in the services sector; and 33 percent of our export is services; services exports are, conservatively, better than $60 billion.

We've had some tapering off of that growth rate in the past decade; a large part of that tapering off was due to the new barriers that are evolving in the services area in foreign markets. Our insurance companies are denied the full measure of services in foreign countries by licensing requirements. Our airlines face excessive user charges in foreign airports. Our telecommunications industry is denied the opportunity to compete for new markets in data processing and information. The list is just endless.

So, in terms of negotiating some hope for improvement of the situation, we've been doing our consensus-building for the most part through the OECD. We've been working with our industrialized trading partners to improve our understanding of significant service trade issues.

This work led, in June, to the adoption by the OECD of a resolution which endorsed the increased retention of services in the OECD and established the political commitment to a multilateral effort to establish rules in services trade. It also strongly supported the preliminary study of services being conducted by the GATT.

The GATT secretariat prepared an excellent paper on services for review by the Commerce Committee Group of 18, which is the steering group of the GATT. The paper reviewed the historical role played by services and considered the question of whether some existing GATT provisions could be extended to trade in services.

We expect and intend that services should be an important agenda item at the GATT ministerial meeting next fall. We intend to see that the preparatory work required to advance the trade in services issue will be carried out well in advance of that meeting. Our goal is that the GATT ministers provide for the establishment of concrete work objectives in this area. I will devote a lot of my own personal time to that process.

Domestically, we have been very active in analyzing impediments to trade in services on a sector-by-sector basis. We currently have studies at various stages of completion, that will provide for each major service sector: On analysis of the trade objectives, government policy objectives, current international arrangements for addressing problems, and possible approaches to future negotiations.

Again, we are trying to develop a consensus within government, and within the individual sector industries, on the objectives and the framework for negotiations. We're also using the studies internationally, to promote discussing an understanding of the trade in services problem. We have, in addition, the development of cross-cutting functional studies that will focus on the most common issues for the most common services—such as government procurement, subsidies, regulations, standards, the role of public monopolies, custom problems, and market access issues.

After completion of this process, we should be in a position to develop concrete U.S. negotiating proposals and an overall approach for attacking these problems in the appropriate international fora. We have a goal for completion of this process by April.

We do need to establish our own goals and objectives first. We also need to establish that kind of consensus-building process or support process among the other countries in the trading community.

The two most common complaints we have in this area are: The inability to establish at all, in foreign countries, and the discriminatory treatment accorded to foreign firms once they have been established in a market, if they get in at all.

DISCRIMINATORY TREATMENT ANALYZED

Any international code must deal with these two issues. The concept of reciprocity and the national treatment—both of which are addressed in the GATT—are important principles which should be considered for inclusion in any code of conduct to address these problems. The national treatment says that governments should treat foreign firms on a basis that is no less favorable than that provided to domestic firms.

These concepts, while valid on their face, must be carefully analyzed before they are specifically applied to international rules governing service sector trade. Some of these principles can be established for all service sectors, to the extent that they lead to the establishment of equivalent competitive opportunity.

The objective may be achieved by an exchange of concessions between the two countries, that are judged to be of equivalent value. A careful analysis will have to be made of the individual service sectors, to determine the limits of reciprocity and national treatment.

But I would suggest that the latter is applicable in most situations. In other words, if we can get national treatment, we will achieve a great deal of our desire to remove these barriers that deprive us of competitive opportunity.

I did mention in the paper the steps that we have to take domestically, which you are thoroughly familiar with, in terms of removing our own disincentives which have a particular burden on the trade in services. We have lifted the taxes on Americans working overseas. It is worthy of some further thought as to whether or not our tax policy, in terms of corporations operating overseas, is adequate.

We need to pass the export trading companies. We need to modify, improve, and clarify the Foreign Corrupt Practices Act, and go beyond the problem that is imposed by inhibitions of U.S. law.

I want to add one other thought. We really do have difficulty in the statistical area. There is a very serious lack of adequate data on international trade in services. This is a problem for our trading partners, as well. People just haven't focused on this issue, in most governments. By some estimates, current U.S. Government data underestimate U.S. exports of service by at least 100 percent. That's an unacceptable number.

We have worked with the Departments of State and Commerce to build another set of figures on the basis of currently available information, and hopefully, will have better numbers before too long. In fact, it is true to say and fair to say that we honestly don't know the magnitudes of imports or exports in this sector—at least, we don't believe we do, in my office.

One concluding thought. We have been evolving an international code under the GATT for trade in goods since World War II. We're settling down to trade negotiations and have made, I think, substantial progress, particularly in the area of reducing tariff barriers. We are less successful in the nontariff area. But we still have made a lot of progress, and the world is a better place because of that.

The United States is better off and the trading community internationally is better off because of that, as well.

To think that it might take us a similar period of 40 years to deal with the services problem is certainly not an attractive prospect. We have a very complicated, very diverse series of industries, but we do have to come to grips with this problem and we have to do so on an urgent basis.

I guess that I have two views in this regard.

In one sense, we don't have time to hurry, because if we rush the process too much we run the risk of failing to develop the political base that would be necessary to achieve a satisfactory response.

By the same token, if we do not create a sense of urgency and movement, both domestically and internationally, it will be far more difficult internationally than domestically. The escallation of barriers in the services trade can have an enormously debilitating impact upon all trade. And I think that would be a tragedy for all of the parties.

SUMMARY OF TESTIMONY

So, I guess what we're looking at are several approaches. To summarize what I've said: To do the basic analytical work domestically; to try to communicate that to our trading partners; and to get the OECD and the GATT to undertake similar studies, both in the horizontal analysis and a cross-cutting analysis, as well as the vertical analysis, of each sector.

In the process of negotiation, we may seek several different initiatives: We should seek amendments to certain GATT codes; we should seek a general GATT code on services per se; we will seek OECD understandings for some of the services sectors; and, we will have to resort, in my judgment, to bilateral negotiations, as well. I don't think this is a problem that has an easy or quick solution. I think that it does require as comprehensive an approach as we can apply, and it will be a matter of major priority for this administration, in analyzing our goals for the entire trade problem for the 1980's.

I thank you, Mr. Chairman.

[The complete statement follows:]

Statement of

Honorable William E. Brock

United States Trade Representative

I am pleased to appear before this committee to discuss the need to liberalize trade in services. It was not too long ago that trade in services was considered to be only an auxiliary trade policy issue, one requiring -- and receiving -- little attention. Today this issue is firmly planted on national and international trade policy agendas and, in fact, the removal of impediments to trade in services has become the number one negotiating priority for the near future.

It should come as no surprise that services has become such an important economic and trade issue. Services as a percentage of Gross National Product (GNP) has increased sharply over the past decade in virtually all of the industrialized countries and in a number of developing countries. The exchange of services is also becoming increasingly important in the world economy. Services now account for about one-fourth of all trade and has been growing over the past few years at a rate of over twice that of trade in goods.

The growing significance of services in both domestic economic structure and trade is particularly important to the United States because of our position as the world's largest services economy and the world's leading services exporter. Services now account for about 65 percent of our GNP and employ 71 percent of our non-agricultural employees. The U.S. services sector has by far been the most dynamic sector of the U.S. economy for more than 30 years. Likewise, U.S. exports of services have grown dramatically. About one-third of total U.S. exports are services. It has been estimated that in 1980 our service industries exported over $60 billion worth of services.

There is some evidence that in recent years we have not been achieving the high level of growth that we experienced in the past. This is not entirely the result of legitimate foreign competition, but in large part the result of the unchecked growth over the years of barriers to trade in services. For example:

- U.S. banks are currently prohibited from establishing in a number of countries;
- Our insurance companies are arbitrarily denied licenses to offer their full range of services;
- U.S. airlines are discriminated against through excessive airport user charges, inferior ground handling services and exclusion from travel agency reservation systems.
- The U.S. data processing and information industry is often prevented from competing in the market for new telecommunications, data processing and information services.

Our trade policy must keep abreast of structural changes in our economy and trends in world trade. We must pursue policies which enhance our competitiveness in those areas where we are strong and enjoy a comparative advantage vis a vis our trading partners. For this reason, the Reagan Administration is firmly committed to seeking a substantial liberalization in trade in services. The time has come for the world trade community to extend to services the principles of fair trade and to develop an international framework for resolving services trade problems.

It is urgent and of benefit to all countries that we proceed as quickly as possible in removing the trade distorting effects resulting from the numerous non-tariff barriers to trade in services. We simply cannot hope to maintain the open trading system nations have worked so hard to develop, if we exclude from the system that element which is its fastest growing component and accounts for about one-fourth of world trade.

This morning I would like to discuss the efforts we are undertaking to improve international cooperation in services and develop the foundation for future multilateral negotiations on services. Generally speaking, the work being conducted is designed to develop both the domestic and international consensus required before trade officials can sit down and effectively negotiate international agreements on services. We have made a good deal of progress in building this consensus and I anticipate a more accelerated effort over the course of the next year.

At the international level, we have been doing our consensus-building for the most part through the Organization of Economic Cooperation and Development (OECD). In the OECD, we have been working with our industrialized trading partners to improve our understanding of significant services trade issues pertaining to such key service industries as banking, insurance, shipping, construction/ engineering, and information and data processing. This work led in June of this year to the adoption by the OECD Ministerial of a resolution which endorsed the increased attention to services in the OECD and established a political-level commitment to a multilateral effort to establish rules in services trade.

We have also voiced our strong support for the preliminary study of services which is being conducted in the GATT. The GATT Secretariat recently prepared an excellent paper on services for review by the Consultative

Group of 18 (CG-18), a steering group of the GATT. The paper reviewed the historical role GATT has played in services, and considered the question of whether some existing GATT provisions could be extended to trade in services. The issue of services should be an important agenda item at the GATT Ministerial meeting scheduled for next Fall. I intend to see that the necessary preparatory work required to advance the trade in services issue will be carried out well in advance of the meeting. Our goal is that the GATT Ministers provide direction to the establishment of concrete work objectives in this area. I will devote a great deal of my personal time to this process, raising services questions with my counterparts so that they appreciate the significance of this important trade item.

Domestically we have been very active in analyzing impediments to trade in services on a sector by sector basis. We currently have studies at various stages of completion that will provide for each major service sector on analysis of 1) the trade issues, 2) government policy objectives, 3) current international arrangements for addressing problems, and 4) possible approaches to future negotiations. The purpose of these studies is to build a consensus within the government and with the individual industries on the key objectives in each sector and on a conceptual framework for future negotiations. These studies will also be used internationally to promote discussion and understanding of these service sectors.

At the same time we have underway the development of cross-cutting functional studies that will focus on the most common issues for all service sectors, such as government procurement, government regulations, standards, subsidies, the role of public monopolies, customs problems and market access issues. After completion of this process, we should be in a position to develop concrete U.S. negotiating proposals and an overall approach to attacking these problems in the appropriate international fora. We are aiming to achieve this by next April.

I view this as a crucial process not only in establishing a basis framework within the U.S. Government as to precisely what our goals and objectives are in the services trade area but enabling all of our trading partners to develop a better understanding of what is at stake for them in this process. What is absolutely essential in the coming months is a cooperative process in which we think through some of the traditional trade rules as embodied by the GATT and other organizations and determine how effectively they fit into the service sectors. For example, perhaps the two most common complaints heard from service industries are the inability to establish in many foreign countries and the discriminatory treatment accorded to foreign firms once they have been established in a market. Any international code of conduct must address these problems in some way.

The concept of reciprocity and the national treatment provision, both of which are addressed in the GATT, are important principles that should be considered for inclusion in any code of conduct to address these problems. The national treatment principle says that governments should treat foreign firms on a basis that is no less favorable than that provided domestic firms. Reciprocity, in literal trade terms, means that there will be equal treatment applied to given products and services at home and abroad. However, we should not lose sight of the limitations of these two important concepts if literally applied to some service sectors. In the banking sector, for instance, a strict application of reciprocity would require that foreign banks be permitted to cross interstate lines in contravention of existing Federal and state laws. Similar problems of sovereignty established for fundamental financial policy reasons would make it impossible for other countries to reciprocate in kind.

Thus these concepts, while valid on their face, must be carefully analyzed before they are specifically applied to international rules governing service sector trade. At the same time, however, some of these principles can be established for all service sectors to the extent they lead to the establishment of equivalent competitive opportunity. The objective may be achieved by an exchange of concessions between two countries that are judged to be of equivalent value. A careful analysis will have to be made of the individual service sectors to determine the limits of reciprocity and national treatment, but I would suggest that the latter is applicable in most situations.

Another aspect of our domestic efforts in services, and one which is fundamental to the development of a viable services trade policy, is the removal of domestic export disincentives. A number of service industries have indicated that various U.S. laws and policies represent a more serious obstacle to their exports than foreign trade barriers. The construction industry, in particular, falls into this category. The most frequently mentioned of these export disincentives are familiar to the Congress. They have been addressed in legislation, including the Economic Recovery Tax Act enacted last summer which eases requirements on taxation of Americans working abroad.

Additional legislative efforts under consideration include the Export Trading Company Act and changes to the Foreign Corrupt Practices Act. We have been working closely with service industries and Congress to assure that efforts to deal with export disincentives fully take into account their interests. Because service industries are, in many instances, labor-intensive, tax relief on income earned abroad as recently provided by Congress will be a major assist in promoting U.S. service industries abroad and the tax savings will sharpen the U.S. competitive advantage in a number of professional services.

Likewise, enactment of the Export Trading Company legislation will go far in bringing small and medium U.S. service firms into the export sector of the economy. We continue to urge its passage. We will also continue to stress the importance of changes to the Foreign Corrupt Practices Act that will clarify rules to exporters in this sensitive area.

While I am on the subject of our domestic efforts in services, I should mention the serious dimensional problem caused by the lack of adequate data on international trade in services. This is a problem for our trading partners as well. By some estimates, current U.S. Government data understates U.S. exports of services by at least 100 percent. In addition, very little data is available for trade in individual service industries or for individual countries.

Major changes will be required to remedy this situation. To prepare the groundwork for a major overhaul, USTR, the Department of State and the Department of Commerce sponsored two research contracts -- one to build a better set of figures on the basis of currently available information and the other designed to develop recommendations for improving official government data. The first of these projects was recently completed and estimates that exports of services in 1980 were in excess of $60 billion instead of the $35 billion figure published in balance-of-payments data for that year. The study also provides us with information that there may be important gaps in our official data.

The second of these projects, which is still underway, will provide the government with recommendations for improving the gathering and tabulation of government data on services. Once completed, steps must be taken to establish a private advisory panel and an interagency committee to evaluate the recommendations and develop proposals for their implementation.

A lot of people have asked me how long this process will take and whether we can afford to wait another 10 years of careful consensus-building before meaningful arrangements can be drawn up to cover services trade. When dealing with industries as diverse and whose problems are equally complex, we cannot afford to rush the consciousness-raising, consensus-building process both at home and abroad. To do so would render the effort a certain failure as countries with less awareness of the issues will resist any undertakings without being fully apprised of their potential implications.

At the same time I think the process requires a greater degree of urgency than has recently been shown. We have now graduated from the stage of realizing the importance of services in our economy to the level of sorting out the problems and identifying specific negotiating objectives. I cannot say at this stage precisely how the framework will appear. It could be a combination of amendments to certain GATT codes, a general GATT Code on Services, OECD understandings for some services sectors, or the resort to bilateral arrangements. Whatever the package, I sense a degree of urgency from our services industries, many of whom have trade problems requiring urgent attention. That is why we are looking for tangible progress within the coming months that will enable us to formulate a multilateral agenda for attacking barriers to services trade. In the meantime we will make every effort to resolve current services trade problems by whatever means available to us, including for example formal and informal bilateral discussions with our trading partners.

Senator HEINZ. Mr. Brock, we thank you. It's certainly clear that we have a lot of agencies that deal with export-related issues and the problems of our service industry: The Federal Reserve deals with certain banking issues; the Commerce Department deals with certain other issues; the Treasury Department, others still. So it's fairly clear that there is a monumental challenge to pulling all these disparate industries, their disparate government regulators or advocates, into some kind of structure. What are we doing about that?

And are you going to be the principal "puller togetherer" of these disparate elements that have been so hard to really get together, to shape consensus in the form of a U.S. position on services?

SPEAK WITH ONE VOICE

Mr. BROCK. That, as I understand it, is my mandate under the law which the Congress passed 3 years ago, under Reorganization Plan No. 3. We have a very clear obligation to see that we speak with one voice in this Government, and we have the mechanism to do that under the Trade Policy Committee structure, and the subgroups, the Trade Policy Negotiating Group, the Trade Policy Review Group, the Trade Policy Subcommittee structure.

Senator HEINZ. We're going to have the Treasury testify after you. Are you going to be speaking, in a sense, for them, as well?

Mr. BROCK. I think we speak with essentially one voice, Mr. Chairman. The Assistant Secretary is beside me now. I see no difficulty in working with Treasury on this issue. We have absolutely common objectives, common purposes. We both see the problem in terms of U.S. interests. We both know it has to be dealt with. Fundamentally, we have to first evolve U.S. Government policy. In that regard, we wouldn't begin to try to do something like that without Treasury being the principal participant, because they have so much involvement through banking insurance and all the rest.

U.S. BANKS BEING DISCRIMINATED AGAINST

Senator HEINZ. Let's get down to cases for a moment. The Treasury Department is quoted, in a GAO report that was drafted in September and is being circulated for comment, as saying, in effect, they didn't feel there were very significant problems to U.S. banks operating abroad. Now, it seems to me there are very significant problems to U.S. banks operating abroad. And while no one is necessarily advocating mirror image legislation, we do have precise reciprocity, for example. Nonetheless, it seems to me that we shouldn't say everything is really all right, and ignore these problems.

What should we do with respect to the problem of the fact that our banks are being discriminated against, they are not receiving national treatment? How should we deal with that?

Are there any changes that you are urging on other elements of the administration? Is there anything that you intend to urge on us?

Mr. **Brock**. I am not sure we are prepared yet to urge a specific course of action. We have tried to date to deal with those problems by bilateral work, but the real difficulty comes not so much with the problem of a particular country but with an evolving pattern of barriers that goes across national lines. In that sense, I don't think the U.S. Government or any other government has adequately focused on the need for some cross-cutting, overarching principles that could be adopted under the GATT to deal with the difficulty of achieving national treatment. That is our most fundamental problem for U.S. banks, as they operate in the international arena.

I should say that our banks have been remarkably competitive internationally and have done a good job. I think perhaps that was the genesis of whoever made that remark in the Treasury Department. We have been very successful because we have the best bankers in the world. We have funds, and confidence, that is simply not available in most other nations. So there is a demand for the service that has helped us to overcome some of the barrier problems.

But, we do need in the not too distant future the establishment of some governing principles to reduce these barriers on a generic basis, across the board. And that's precisely what we would hope to evolve, first as a matter of U.S. policy, and then as a matter of international law.

Senator **Heinz**. Is the reason that we get discriminated against because we're so good other nations don't feel they can compete equally with us; that our competitive advantage is in fact real? Is this the reason we're discriminated against?

Mr. **Brock**. I think that's part of it. But part of it is just that when you're talking about the services industries, they are generally the most regulated of domestic industries in every country, and we are not immune to that process.

If you look at U.S. law, from the perception of someone who wants to come into this country, we would be a pretty tough place to do business, too. We have a wide open market; that's true. But we have 50 different State laws that govern and regulate banking, and that's very tough for an international firm that wants to come in here. How do you deal with that?

Senator **Heinz**. It's not easy on American banks, either.

Mr. **Brock**. No, it's not. But if you think we're confused, view it from the perspective of someone from Brazil or Japan, or Australia, that wants to come over here and set up their own institution. It isn't a simple problem.

I think we have determined it's in our interest to have some regulation of the banking process, and in that sense, those barriers may not be designed to discriminate. They may be designed to accommodate what is perceived as the national interest of the particular country. It is when they become discriminatory in fact, when they use the regulations not for domestic economic purposes—but when they use the regulations to discriminate, that we, I think, have to deal with the problem. That's where we're getting today.

DEVELOPING BETTER INFORMATION ON TRADE SERVICES

Senator **Heinz**. Mr. Ambassador, you have said that you're going to take the lead in a variety of ways. I gather that includes gathering better information on trade and services. I understand a few years ago both Japan and the United States discovered, somewhat ironically, that each had a deficit in services trade with the other. Obviously, that is what is called a little less than zero sum trading relationship.

We don't have anywhere near the kind of information in this area that we probably need in order to know what we ought to be doing, and for the world to understand what it should be doing.

In terms of merchandise, I guess, there are several thousand categories, 6,000, 8,000, 10,000 categories. In terms of trade and services, I understand there are only 6,000. And some of those are pretty hard to read, because you will find in services the repatriation of profits from U.S. investment abroad—no one knows quite in what category they end up. As I understand it, you will be trying to develop that information system; is that right?

Mr. **Brock**. We are trying to do that now. We have just completed one study to demonstrate the magnitude of the problem. We have a second one ongoing to see how best to get buffer data, and then it is going to take some time to achieve a structure to do that.

You will find in Marc Leland's numbers a different set of figures from ours, because Treasury is going at it from the point of view of services and investment as an encompassing number. We deal with services and investment as separate issues. They're both trade issues. But they are separate data.

It is not easy—but it can be done—to accumulate numbers when you're exchanging ashtrays or shirts, because they go through a customs process. There is no similar procedure for dealing with the flow of information, the flow of dollars, the shifting of accounts in banks or insurance companies. It is a fairly difficult number to come up with.

Senator **Heinz**. Given this kind of difficulty, how difficult is it going to be to make any progress in negotiations, let us say, at the GATT ministerial next year, in terms of getting a much more term-clear international understanding about what the rules of behavior ought to be?

We made a lot of progress, I think, in the MTN of 1978-79, the Tokyo rounds. But that strictly had to do with merchandise, really, and as you yourself pointed out in your opening statement, we have made a lot more tangible progress with respect to tariff barriers. Nontariff barriers are still, as I suspect, we'll learn in our next set of hearings, very much with us. Indeed, there is a lot of evidence that they are proliferating on merchandise, not just on services.

Are you optimistic that you are really going to get some progress in this area on some kind of multilateral understanding?

Mr. **Brock**. Yes. But that's because I feel that it is so utterly necessary that we make progress. It is unacceptable that we should not move in a positive direction. We simply cannot tolerate the continuing explosion of new burdens in this area of trade.

I am optimistic, but I don't underestimate the problem at all. We first have to sell other countries on the fact that they have a vested interest in seeing some regime of discipline in the market, in the exchange of services. Then, having done that, we have the inordinately complex task of trying to see, can we evolve certain common principles that will govern trade in services across the board. How much can we do in that area, in terms of the crosscuts, the set of principles? Then how much are we going to have to do by sector—because there are clear obvious differences between shipping and banking and insurance and engineering, and movie-making, and data processing.

Some of these problems you are going to have to deal with fairly narrow, on a vertical basis, within that particular sector, to evolve some sort of a code. Some you can do across the board. I don't underestimate the problem at all. I think it's very, very difficult, and it's going to take time.

Senator HEINZ. Senator Proxmire.

Senator PROXMIRE. Ambassador Brock, it's great to have you back here. You have starred for years as a member of this committee——

Mr. BROCK. I gave you the best years I had.

Senator PROXMIRE. You were awfully effective—too effective, often.

Mr. Ambassador, I am concerned about part of this in this way: You say on—page 2 of your statement, you have a list of problems here: U.S. banks are totally prohibited from establishing in a number of countries. Insurance companies are arbitrarily denied licenses to offer their full range of services. No. 3, U.S. airlines are discriminated against through excessive airport user charges, inferior ground handling services, and exclusion from travel agency reservation systems. Then fourth, the U.S. data processing and information industry is often prevented from competing in the market for new telecommunications, data processing, and information services.

I think that's an excellent analysis of the problems. But it kind of reminds me of the barber, who was a great fellow for putting on lather but never got around to using the razor to take the beard off—because I don't see in the rest of your statement any indication or recommendation for legislation, no guidance on policies, no indication of progress or support from the administration in any of these four areas.

I realize you have only been in a year yet. But I am just wondering where we're going on these things. Are we going to make progress in any of these areas?

Mr. BROCK. I think that's an absolutely fair question. I guess I have two answers for it.

One, right now, because of the absence of an international code for governing the conduct of goods and services as it does for trade in goods, or tangible goods, we have to deal with these things almost as a firefighting team. I have got 113 people in my entire agency. They simply cannot spend all their time trying to deal with individual problems, with individual companies, in individual countries, or we're never going to achieve the fundamental redress which is the necessary ingredient of a central controlling code of law that will govern conduct in the international community in this area. So we are, frankly, trying to draw as many resources as we can from our other obligations and focus them on achieving this international agreement.

You first have to sell a substantial number of countries that there is a problem at all. Not many recognize that there is. Second, you have to go to something like a Ministerial level process to establish the political will and commitment. It's not been done. That, we hope to achieve in November of next year.

But in response to both yours and John Heinz' previous question, I don't expect the GATT ministerial to engage in serious negotiations. What I hope for, at a minimum, is a mandate or political commitment to begin that negotiating process. We haven't had a GATT ministerial at all since 1974, if I recall. It's going to take some time to work these things out.

In the meantime, we'll engage in all the firefighting activities that we can. We will negotiate as best we can bilaterally to reduce the barriers. We do that daily, with some success. But, we're not going to be able to get at the root of the problem until we establish an international code.

Senator PROXMIRE. I appreciate that. I hope you can establish an international code.

But take the very first point: "U.S. banks are being prohibited from establishing in a number of countries." True. As I say, we have passed an International Banking Act that says while we do have complicated regulations in this country that we would treat foreign banks exactly the same as we treat domestic banks. And our bankers don't have that.

Senator HEINZ. Senator Proxmire, I think we treat them a lot better.

Senator PROXMIRE. That's right. The branching, for example. But there's no more significant area, at least, that they're discriminated against here. And we are discriminated against abroad.

It seems to me, if, as you say—and as the chairman of the subcommittee has indicated—our bankers are outstandingly efficient, that means they can provide a good service abroad, as you know, as they do here in this country. That, it seems to me, ought to be a strong argument for our getting equal treatment.

Then, on U.S. airlines, excessive airport user charges, inferior ground handling services, and so forth, it seems to me that that's the specific kind of a disadvantage that we should challenge directly, vigorously, and constantly. Yet I don't see that. I just get the feeling that we're complaining about it, but we're not really challenging those countries to treat us fairly.

Mr. BROCK. Let me disagree. We have challenged a number, and we have done so with some degree of success. The problem is if you do only that you're not dealing with the fundamental problem.

Senator PROXMIRE. I agree with you there.

PROTECTIONISM POLICY PROBLEMS

Mr. BROCK. Every time you deal with one minor form of protectionism, 10 new ones will creep up on you. And you have got to keep your eye on the long-term goal of the international code.

Senator PROXMIRE. Let me just ask a general question on another part of this, because I think it bothers many people. I have argued—and maybe I have been unfair—that the administration is not following the kind of vigorous free trade policy we ought to follow in this country. That is, we have trigger prices on steel. You have arranged very skillfully to restrain some Japanese automobile imports. Both of those are interferences with free trade in this country. Both have some inflationary impact.

And for us to have a persuasive and convincing argument against protectionism in foreign countries, it seems to me we ought to recognize the price we pay when we follow protectionist policies of our own. Is that right?

Mr. BROCK. Absolutely. But it would be very difficult to prove that the Japanese action on automobiles is having an inflationary impact when you see Rosenthal Toyota offering a $1000 discount on new Toyotas in the new model year.

Senator PROXMIRE. It makes sense, though. If we limit the amount of competition they can bring in, doesn't it follow that there's going to be some effect on the price of our own cars?

Mr. BROCK. There would be if there were a healthy U.S. automobile market, Senator, but there simply is not a good market now, because of interest rates. It has nothing to do with imports at all. Interest rates have done far more violence to our automobile manufacturers.

But in fact, if you take that example, both were done in order to avoid falling into greater protectionism. The Congress is talking about a very severe rollback of Japanese cars. That was not done by the Japanese Government. The trigger price mechanism was sought by the European Community to avoid breaking up in disarray over all kinds of dumping and countervailing duty suits. It frankly has been less than fully successful, because there has been some dumping in this country at below cost, as you well know.

Senator PROXMIRE. It bothers me so much because it's a departure from our past policies, limiting imports in this particular way, particularly in industry, which was the best in the world. Our automobile industry has just been unparalleled until just the last 10 years, even 5 years.

Mr. BROCK. I frankly believe that if we take some steps that are less than fully good, but certainly less bad than the alternative, that you can still make progress. And I hope it's not perceived as an action of protectionism, but rather trying to avoid much more severe types of protectionist responses.

I think in that case we have succeeded rather remarkably, with the possible exception of the dairy area, where we have the most protection of all.

Senator PROXMIRE. Let me get to another subject. [Laughter.]

My final question is this. You say our banks are doing a good job overseas. The fact is that our banks have been losing ground, and one blatant area of discrimination is in data processing, for example. Some countries, in order to build up their own data processing, require data processing to take place within their borders, rather than to allow the more efficient system of processing where it's most efficient, using telecommunications systems. Jobs in United

States are lost. Is the transnational data processing problem a priority with your office?

Mr. BROCK. Yes, and increasingly so. That's an area where all kinds of politicians are playing all the kinds of games they can play around the world. And it's a very, very worrisome thing to watch the development of that pattern.

There are two or three different interagency programs going on. We are trying to work through the trade policy to coordinate the trade aspects, but there are other forms of discrimination that don't really deal with trade. They deal with things as basic as freedom of information and the exchange of knowledge. A number of agencies are working in the area. Jim Buckley over at State is heading up a group in that area that I hope will achieve some results as well.

Senator PROXMIRE. Well, it's an emerging technology, as you know, and it seems to me you ought to go after it very hard now.

Mr. BROCK. I agree thoroughly.

Senator PROXMIRE. Thank you, Mr. Chairman.

POSSIBLE CONGRESSIONAL ACTIONS

Senator HEINZ. Mr. Ambassador, one last question. You've indicated that you have a lot of work underway in the services area that you're going to be developing information that you're not sure at this point whether you need anything from the Congress to strengthen your negotiating position. Is it possible that you will come to the Congress and ask us for specific authorities, powers, mandates? If so, when might you do that?

Mr. BROCK. It's very possible. I would think that it would be no earlier than March or April when they complete this preliminary work. There are some bills up here now that we have an interest in in the services area. But basically, if we're looking at it in a fairly broad sense, I would rather wait and be fairly sure of what it is we fundamentally need.

The Congress was ahead of the administration, frankly, by restating the fact that when you passed the Trade Act, you intended that to cover trade and intangible goods, as well as tangible. That was an enormous help to us. We do have a good deal of authority now. Whether we need more or not remains to be seen.

Senator HEINZ. So you would anticipate you could be back to us in the spring of next year, not necessarily the early spring, but the spring of next year, with some more specific recommendations of which you might seek congressional actions?

Mr. BROCK. Yes, we may have some specific need before then, in which case we'll be back very quickly.

Senator HEINZ. But as of today, you're not seeking anything; is that correct?

Mr. BROCK. That's correct.

Senator HEINZ. I think this hearing is useful in two ways, Mr. Ambassador. One, I think it brings us up to date on what you and the administration are doing. And to your credit, you have not denied—you've been looking into these problems, they're not going to be solved overnight. You've been giving them appropriate priorities.

The second reason is to find out how bad these problems are. Unfortunately, even you have to admit that we don't have enough information on a worldwide basis to show, with great explicitness, how bad these problems are, but they are clearly not good. I think you would agree that problems are getting worse, not better.

Mr. **Brock**. Yes.

Senator **Heinz**. Finally, I think it is important for the public in general to realize just how much this kind of problem can potentially impact our ability to grow economically.

You pointed out in your statement that nearly two-thirds of our economy is now a service-based economy. Yet service-based exports—and there are lots of opportunities, Senator Proxmire has pointed out, in terms of international data flows, emerging technologies, that could put a lot of people to work in this country doing things of great value. And here we are with our export services stuck somewhere right around 30 percent, 67 percent of our economy being based on services.

So, the potential here, both for ourselves and others, is extraordinary. And we don't want to see all these other countries unilaterally going around repealing the law to their advantage.

It's going to be necessary for us to take a very aggressive stance in this area.

Mr. **Brock**. Absolutely. And don't underestimate what services are doing for us in a positive fashion, even on the old data and admitting that it's inadequate.

We had at least a $38 billion plus contribution to our balance of trade in goods and services because of the services sector last year. That's an enormous positive development that we could very ill afford to do without.

Senator **Heinz**. Mr. Ambassador, thank you very much.

Our next witness is Marc Leland, Assistant Secretary for International Affairs in the Department of the Treasury.

STATEMENT OF MARC E. LELAND, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, ACCOMPANIED BY JAMES. E. AMMERMAN, DIRECTOR, OFFICE OF INTERNATIONAL BANKING AND PORTFOLIO INVESTMENT, OFFICE OF THE ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

Mr. **Leland**. Thank you, Mr. Chairman.

I appreciate this opportunity to discuss with you Treasury's interest in the international services area, particularly with respect to banking and securities.

I've submitted for the record a prepared statement. I will run through it and try to summarize it in one form or another.

Senator **Heinz**. Without objection, your entire statement will be made a part of the record at the end of your testimony.

Mr. **Leland**. Thank you.

Ambassador Brock has outlined for you the importance the U.S. Government attaches to efforts to increase international awareness of present barriers to trade and services and develop a consensus to reduce them.

I think, in answer to your question I would like to reiterate his answer. He is the principal coordinator in this area.

We have a particular interest in, and have taken primary responsibility for, developing and working out strategies in the banking, securities, and financial services area, but working very closely, as I said, with Ambassador Brock as coordinator. All of these issues go, in one form or another, through the TPC, which he chairs.

AVOIDING SALAMI TACTICS

This administration is very conscious of and is avoiding what are known as salami tactics, whereby each of us is dealing in a different area and the people we're negotiating with, in a sense, can attempt to divide us up.

As you very well put it, his role is as the principal coordinator pulling together everything we do in talking to our allies or anybody we're negotiating with. We're clearly doing that, and we're in constant contact with each other.

Obviously, the Secretary of the Treasury has close relationships with other Finance Ministers and sees them on a regular basis. And these are particular topics that come up in his discussions with them.

What I plan to do this morning is to review briefly, at your request, the importance of services in U.S. international transactions, something you are well aware of, and more particularly, recent developments in U.S. policies on international banking. I'll then discuss our objectives and the key problems we face. But as Ambassador Brock stated, the other witnesses will deal with specific problems more directly and more precisely than we can do. Finally, I'll indicate how we'll continue to support U.S. banks' and financial firms' interests overseas.

As Ambassador Brock said, until recently the service sector has received very little attention in most analyses of the U.S. external position. However, given the importance of the services sector to our economy as a whole, it's not surprising that service transactions have become a large and growing part of the U.S. international activity.

In traditional balance-of-payments accounts, services include tourism, travel, royalties, and fees, as well as direct investment income, interest on bank loans, and military sales and services. On this broad basis, gross flows of both receipts and payments from service transactions have increased from $43 billion in 1970 to $205 billion in 1980.

Growth in investment income has been the major factor behind the growth in our services surplus as a whole and reflects the return on U.S. direct investment overseas, which has grown substantially over the past decade.

Banking and securities transactions accounted for the major growth in U.S. capital flows in recent years. In 1970, when gross recorded capital flows in the U.S. balance of payments accounts were $16 billion, direct investment flows accounted for $9 billion of that total, so that all other types of flows, mainly banking and securities, accounted for less than half the total.

Last year, these banking securities and miscellaneous flows accounted for nearly 80 percent of the $135 billion total. These figures demonstrate clearly the importance of the banking and securities industries to the strength of our external payments position with regard to both services and capital transactions. Liberalization of foreign restrictions would help to enhance this growth and would benefit the global economy as a whole.

The International Banking Act of 1978 is a good starting point for looking more closely at the banking and financial sector. This act, passed after extensive congressional deliberation, established a comprehensive Federal Government role in the regulation of foreign bank participation in domestic U.S. financial markets. The guiding principle of the regulatory framework was to provide national treatment for foreign banks, giving them equality of competitive opportunity with their domestic banking counterparts in the United States.

At the same time, the International Banking Act, also required the Secretary of the Treasury, together with other relevant agencies, to submit a "Report to Congress on Foreign Government Treatment of U.S. Commercial Banking Organizations." The Treasury published this comprehensive study in September 1979. It provided a detailed assessment of impediments to U.S banking operations in most major countries of the world.

The study classified various types of restrictions affecting U.S. banks operating abroad. Some of these effectively increase the cost of doing business. Examples include discriminatory differential reserve requirements and prohibitions against accepting retail deposits. Others are limitations on the activities of the banks, such as lending ceilings, swap limitations, and prohibitions or limitations on branching.

Since the report was published, major developments have occurred within the U.S. market. One of these is the Depository Institutions Deregulation and Monetary Control Act of 1980, which is bringing a sweeping modification to our own domestic regulatory climate. Another is the establishment of international banking facilities, which will begin operation on December 3d.

The administration also strongly supported the Heinz/Danforth bill, passed unanimously by the Senate in April. Under this legislation, banks would be able to invest in export trading corporations, subject to specific safeguards. It would enable U.S. banks to be a driving force behind the establishment of ETC's as an excellent source of capital, international offices; experience in trade finance, and familiarity with foreign customers and U.S. producers and exporters.

The International Banking Act of 1978 enunciated the principle of national treatment as the U.S. Government's policy in the field of international banking.

SEEKING NATIONAL TREATMENT

This is covered, in more detail in my statement. But basically, our philosophy is that if we can gain access to foreign markets and then receive national treatment when we are there, this will achieve our basic objective.

We know some are tempted to seek reciprocity. As Ambassador Brock pointed out, however, a strict reciprocity, given our own panoply of laws, differing from requirements that other countries may justifiably have, is not our real objective. Our main and most useful objective is to be treated within foreign markets the same way their own banks are treated, and this will provide more support for most of our interests.

What is important to determine is whether the central banking and financial authorities of foreign countries are trying to be fair and evenhanded in their treatment of U.S. banks and whether the local banking industry is itself an advocate of a level playing field. Tough competition is one thing; unfair competitiion is another.

The question of the right of establishment for U.S. banking operations overseas and for foreign banks in this country is important and complex. The administration wants to encourage the continued development of the United States as an international financial center. Establishment of foreign banks and subsidiaries provides capital to our economy, improves the competitive climate, and creates jobs and tax revenues. We have to be very careful in deciding whose nose would be cut off if a foreign bank were denied entry because of something we wanted to accomplish in any specific country.

The issue of takeovers is equally sensitive. Federal Reserve Board studies show improvement in the operations and capital structures of U.S. banks that have been taken over. In other words, there have been demonstrable net benefits to the U.S. economy and financial structure from the strength and support of foreign owners. But there's the problem of perceived unfairness, and that has been addressed more directly in proposed legislation that would reduce the impediments to takeover by domestic banks of distressed financial institutions.

This brings me now to where progress has been made and where problems remain.

The Treasury cooperates with U.S. banks and securities firms and attempts to work toward national treatment to bring about the removal of impediments to their operations. I have already indicated that the "1979 Treasury Report to Congress on the Foreign Treatment of U.S. Commercial Banking Organizations" identified a wide range of issues, often in the developing or newly developed nations. U.S. banks and securities firms have been helpful in identifying the problems.

Indeed, cooperation with individual banks, investment houses, and trade groups, such as the Bankers Association for Foreign Trade, the American Bankers Association, and the American Banks' Association of London is in many cases the starting point for the formulation of our own policy judgments.

As Ambassador Brock mentioned, given the limitations on staff budgets and so forth, you can't adequately cover the dimension of the problem with either Treasury's available staff or the USTR's available staff. One must look to the industries themselves in this matter.

Let me run down just a short, specific list of examples in countries of interest to the United States. Progress has been made in several countries:

In Canada, foreign banks now can provide the full range of banking services through subsidiaries.

Finland—foreign banks are now allowed to establish banking subsidiaries.

Japan has made progress.

Spain—foreign bands are now able to establish branches and subsidiaries, the United Kingdom—foreign bank branches are now eligible to more fully participate in official export credit guarantee department operations.

There are, of course—and I don't want to belittle them—important problems.

Canada, in the context of the new liberalization, has an 8-percent limit on foreign bank subsidiaries' share of Canadian domestic assets. That may constrain their future growth, though that isn't certain at this point.

In the European Communities, new draft banking directives and harmonization requirements may require discriminatory disclosure of individual branch balance sheets from non-European Community banks.

With the nationalization in France, it's difficult yet to determine exactly what effect that will have on the banks that remain. We know that some banks will lose equity their interest in domestic banks that are being nationalized.

Senator HEINZ. It'll be a little tough on entry.

Mr. LELAND. It could be a little tough on entry. On the other hand, they have indicated—we spoke with the French Finance Minister—that they would probably make room for more international banks to go in.

If they give us the right kind of treatment, we actually could be, to some degree, not so badly off. But it's very difficult for us to know what kind of treatment we will receive.

It is possible—because obviously the Government is inclined to favor its own banks—that they may start being discriminatory against the ones we own. That's what we've got to watch out for.

But so far, they've made the determination, which was good, not to try to nationalize the whole sector and say, "Foreign banks get out," because I think that would have faced us with a very serious problem. It could have had an effect on their banks doing business in our country.

There are problems in Australia, Brazil, Mexico, South Korea, Sweden, Taiwan, and Venezuela. They're all dealt with in my statement, and they're all places where we have problems to a varying degree. And this list is just illustrative and not exhaustive.

But we do, I think, have a good record of making our views known to the foreign governments concerned—of course with more emphasis in some countries than others.

CURRENCY RESTRICTIONS

How do we plan to proceed? In attempting to encourage countries to remove restrictions on the ability of American banks and security houses to compete for local business, progress is, as Ambassador Brock said, often frustratingly slow. To a degree, crossborder lending and liberalization of capital movements helps to achieve internationally what sometimes cannot be achieved directly in a domestic market. For example, sometimes foreigners have been free to purchase securities in the New York market, but a U.S. securities firm could not actually solicit that business in the foreign market. Currency restrictions are another major impediment. We tend to find more difficulties in the developing countries, but several OECD countries still maintain exchange controls.

We raise all these problems during our bilateral meetings with senior foreign government officials. We use our Embassies abroad. We have Treasury representatives based in U.S. Embassies in major financial centers, who have a close and continuing professional relationship with the Finance Ministries.

In general, we try to convince foreign governments of the advantages of developing a modern and sophisticated financial sector. We are now stressing reforms of financial structures in LDC's as part of our bilateral and multilateral aid programs. This, in turn, works toward a more favorable climate for the entry of U.S. banks and securities firms.

The issues involved, as I say—and I will repeat it again—are complex. It's very hard to construct a scorecard, and often a change of economic climate or a worsening balance of payments can bring on the reimposition of exchange controls, which cut across our efforts—however justified the measures may seem to the countries concerned.

We make our views known at the IMF/IBRD meetings. We place great importance—and I think I'd like to stress this—on the ongoing work of the OECD specialized committees, which deal with capital movements and financial markets, and the OECD codes of liberalization of the capital movements, and invisible operations. It's in this area, the multilateral area, particularly in the OECD, that we can try doing for banking services the kind of thing that, as Ambassador Brock said, has already been done to a limited degree with actual trade within the GATT.

In the overall framework of our efforts, Treasury believes that continued efforts to address specific problems and areas of importance to U.S. financial institutions is the approach most likely to yield positive results. Steps in the direction of a larger international framework of trade in banking and related services may be possible. But it's very time consuming to negotiate. And we are not sure exactly what the value of it might be, yet. I should note that the European Communities, which have an agreed mandate to work toward harmonization of banking regulations, have found the process very thorny and much more difficult than they envisioned.

A more targeted and limited multilateral agreement on key principles, such as national treatment and transparency of regulations, may provide a feasible option for the broader services exercise—of which banking might be a part.

Finally, Mr. Chairman, we intend to work closely with the U.S. banking and investment industry in identifying problem areas and working toward satisfactory solutions. I assure you that our objectives and initiatives, whether bilateral, in existing multilateral fora, or in the context of even wider negotiations on services, will continue to reflect your and your committee's desire to work toward national treatment for U.S. financial interests overseas.

[The complete statement follows:]

STATEMENT OF THE HONORABLE MARC E. LELAND
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
SENATE BANKING SUBCOMMITTEE ON
INTERNATIONAL FINANCE AND MONETARY POLICY
November 9, 1981

I welcome this opportunity to discuss with you Treasury's interest in the international services area, particularly with regard to banking and securities issues. Ambassador Brock has outlined for you the importance the U.S. Government attaches to the effort to increase international awareness of present barriers to trade in services and to develop a consensus to reduce them. Treasury has participated actively in interagency discussions of the strategy which the United States might pursue in seeking to reduce barriers of particular concern to U.S. firms, and has primary responsibility in developing the strategy for banking, securities, and related financial services.

What I plan to do this morning is to review briefly the importance of services in U.S. international transactions and recent developments in U.S. policy in international banking. I will then discuss our objectives and the key problems we face in foreign countries in the banking sector, indicating where progress has been made and where problems exist. Finally, I will indicate how we have and how we plan to continue to support U.S. banks and financial firms' interests overseas.

Services Transactions in U.S. External Accounts

Until recently, the services sector has received very little attention in most analyses of the U.S. external position. However, given the importance of the services sector to our economy as a whole, it should not be surprising that services transactions also have become a large and growing part of U.S. international activity -- and, indeed, have contributed in major part in offsetting U.S. deficits on trade account during the past several years. U.S. exports of services accounted for nearly five percent of U.S. GNP in 1980.

In traditional balance of payments accounts, services include tourism, travel, royalties and fees, as well as direct investment income, interest on bank loans, and military sales and services. On this broad basis, gross flows of both receipts and payments from service transactions have increased from $43 billion in 1970 to $205 billion in 1980. The U.S. surplus on service transactions grew from $3 billion to $36 billion during the past decade. The value of our services exports ($121 billion in 1980) is impressive indeed, and compares with services imports of $84 billion.

Growth in investment income has been the major factor behind the growth in our services surplus as a whole and reflects the return on U.S. direct investment overseas, which has grown substantially over the past decade. Earnings on U.S. direct investment abroad were $36.8 billion in 1980, $20 billion higher than in 1970, as compared to U.S. payments to foreigners of $9.3 billion on their direct investments here.

U.S. earnings on private bank and securities transactions in foreign markets also grew by $34 billion during this period and totalled $36.5 billion in 1980. U.S. private payments to foreign holders of U.S. securities and bank deposits similarly grew by $17.7 billion, to a $21.3 billion total in 1980.

Banking and securities transactions also accounted for the major growth in U.S. capital flows in recent years. In 1970, when gross recorded capital flows in U.S. balance of payments accounts were $16 billion, direct investment flows accounted for $9 billion of that total -- so that all other types of flows, mainly banking and securities, accounted for less than half of the total. Last year, these banking, securities and miscellaneous flows accounted for nearly 80 percent of the $135 billion total.

These figures demonstrate clearly the importance of the banking and securities industries to the strength of our external payments position, with regard to both services and capital transactions. We expect continued growth in the future. Liberalization of foreign restrictions would help enhance this growth and would benefit the global economy as a whole.

This administration's goals are clear, and were firmly stated by President Reagan at the 1981 Annual Meeting of the World Bank and International Monetary Fund:

> "Only with a foundation of sound domestic policies can the international economic system continue to expand and improve. My own Government is committed to policies of free trade, unrestricted investment and open capital markets."

The Banking Sector

The International Banking Act of 1978 is a good starting point for looking more closely at the banking and financial sector. The International Banking Act, passed after extensive Congressional deliberation, established a comprehensive Federal Government role in the regulation of foreign bank participation in domestic U.S. financial markets. The guiding principle of the regulatory framework was to provide national treatment for foreign banks, giving them equality of competitive opportunity with their domestic banking counterparts in the United States.

The International Banking Act also required the Secretary of the Treasury in conjunction with the Federal Reserve Board, Federal Deposit Insurance Corporation, the Secretary of State, and the Comptroller of the Currency to submit a Report to Congress on Foreign Government Treatment of U.S. Commercial Banking Organizations. The Treasury published this comprehensive study in September 1979. It provided a detailed assessment of impediments to U.S. banking operations in most major countries of the world, as well as describing both entry restrictions and operating restraints.

The study classified various types of restrictions affecting U.S. banks operating abroad. Some of these effecively increased the cost of doing business. Examples include discriminatory differential reserve requirements and prohibitions against accepting retail deposits; others are limitations of the activities of the banks such as lending ceilings, swap limitations, and prohibitions or limitations on branching. The effect is a reduction in competitive opportunity in those countries which maintain such restrictions. I won't attempt to elaborate in more detail in this testimony but the background is available in the actual report for anyone who is interested.

Since the Report was published, major developments have occurred within the U.S. market. One of these is the Depository Institutions Deregulation and Monetary Control Act of 1980, which is bringing sweeping modification in our own domestic regulatory climate.

Another is the establishment of International Banking Facilities (IBFs); these begin operation on December 3 of this year under rules whereby they may accept deposits from and extend credit to foreign residents or other IBFs. The IBFs are exempt from U.S. reserve requirements and from interest rate limitations that apply to domestic banking operations. Their loans and deposits may be denominated either in U.S. dollars or foreign currencies. We expect many activities now conducted in the Euro-currency markets will be brought on shore. The establishment of these new facilities will enhance the international competitive position of banking institutions in the United States and our role in international finance.

The Administration also strongly supported the Heinz/Danforth bill (S.734), passed unanimously by the Senate in April. Under this legislation, banks would be able to invest in Export Trading Corporations, subject to specific safeguards. It would enable U.S. banks to be a driving force behind the establishment of ETCs as an excellent source of capital, international offices, experience in trade finance and familiarity with foreign customers and U.S. producers and exporters. We hope the House will act soon on similar legislation as well. Coupled with the deregulation provisions and formation of IBFs in the U.S. itself, the climate and opportunities for U.S. banks' international operations then should be markedly improved.

U.S. Objective: National Treatment

The International Banking Act of 1978 ennunciated the principle of national treatment as the U.S. Government's policy in the field of international banking. Foreign banks are permitted to operate in the United States under the same general conditions as domestic financial institutions. Internationally, our objective has been to secure national treatment for American banks operating abroad, namely that they be able to compete in foreign markets on a basis of equality of opportunity with local banks. We believe this is a workable principle, it removes discrimination and, handled in the context of regulatory issues and prudential considerations, is fair and pragmatic.

We understand that some might be tempted to seek reciprocity as an objective in international banking. This is acceptable if we define reciprocity as banks from two countries each receiving national treatment. In the traditional sense in which reciprocity is defined, we don't see it as a viable U.S. objective. Such reciprocity would enable a foreign bank in the U.S. to carry out only those functions which a U.S. bank could undertake in the home country and vice versa. It could well be a step toward protectionism rather than a movement toward greater liberalization. The difficulties inherent in this approach in an administrative sense are obvious. What this would require is uniform banking regulations in all countries. For example, with a 10 percent reserve requirement in one country and 20 percent reserve requirement in the other, it could be argued both countries would be required to change their levels and average out at 15 percent. We don't think this makes much sense.

Internationally, banking rules do not easily lend themselves to strict reciprocity or harmonization, since national goals and characteristics differ. In any case, many of the difficulties faced by U.S. banks in foreign markets are not of a cross border or international trade type, but rather deal with prudential considerations and domestic operating rules. These would be extremely difficult to codify or deal with on a purely reciprocal basis, but they are well handled by the national treatment principle. Perhaps the problem is semantic; in a sense, national treatment in banking is akin to reciprocity in trade.

What also is important is to determine whether the central banking and financial authorities of foreign countries are trying to be fair and evenhanded in their treatment of U.S. banks and whether the local banking industry is itself an advocate of "a level playing field". Tough competition is one thing; unfair competition is another.

A special area where difficulties can arise is in the right of establishment, i.e., the right to set up a branch or subsidiary. If this right is denied, there is no opportunity for receiving national treatment.

The question of right of establishment for U.S. banking operations overseas and for foreign banks in this country is important and complex. The Administration wants to encourage the continued development of the United States as an international financial center. The establishment of foreign bank branches and subsidiaries provides capital to the economy, improves the competitive climate, creates jobs and tax revenues. Whose nose would be cut off if the foreign bank were denied entry?

On the other hand, there is a perceived element of unfairness if foreign banks can operate in the U.S., while our banks are denied the ability to establish branches or subsidiaries in the other country's market. This impediment to some extent can be (and has been) profitably overcome by visiting and cross border lending. Unfortunately, there is no neat solution to the issue, but it is one of those problems we plan to devote more attention to.

The issue of takeovers is equally sensitive, but in some cases these have been to rescue or aid a U.S. bank with difficulties in a situation where U.S. regulations would prohibit the takeover by a domestic U.S. bank. Federal Reserve Board studies show improvement in the operations and capital structure of the U.S. banks that have been taken over; in other words, there have been demonstrable net benefits to the U.S. economy and financial structure from the strength and support of the foreign owner. The problem of perceived unfairness is being addressed more directly, however, in proposed legislation that would reduce the impediments to takeovers by domestic banks of distressed financial institutions. Indeed, foreign takeovers of large U.S. banks have been encouraged by U.S. laws. Domestic banking rules preclude large U.S. banks in other states from being purchasers; antitrust legislation is a barrier to a takeover by a U.S. bank domiciled in the same state.

Where has progress been made; where do problems remain?

This brings me more specifically to how the Treasury cooperates with U.S. banks and securities firms and attempts to work towards national treatment and removal of impediments to their operations abroad. The U.S. Treasury has a long tradition of working to promote and defend the international interests of the financial community, through working for greater liberalization of capital movements and capital markets, encouraging the removal of exchange controls, and promoting national treatment as the most workable doctrine in international banking and financial activities. I have already indicated that the 1979 Treasury Report to Congress on Foreign Treatment of U.S. Commercial Banking Organizations identified a wide range of issues, often in the developing or newly developed nations. U.S. banks and securities firms have been helpful in identifying problems; indeed cooperation with individual U.S. banks, investment houses, and trade groups as the Bankers Association for Foreign Trade, the American Bankers Association and the American Banks' Association of London is in many ways the starting point for the formulation of our own policy judgments. Problems remain, but there has also been some progress. Let me run down a specific list of examples in countries of interest to U.S. banks.

Progress has been made

In Canada:	The Bank Act of 1980 now allows foreign banks to provide the full range of banking services through subsidiaries.
Finland:	Foreign banks are now allowed to establish banking subsidiaries.
Japan:	Foreign bank branches are now able to open additional offices, solicit deposits, issue CDs, and participate in export/import financing.
Spain:	Foreign banks are now able to establish branches and subsidiaries offering full banking services.
U.K.:	Foreign bank branches are now eligible to more fully participate in official Export Credit Guarantee Department operations. Acceptances of established foreign banks are now eligible for discount at the Bank of England if they meet market criteria.

There are some potential problems

Canada: In the context of the new liberalization, there is an eight percent limit on foreign bank subsidiaries' share of Canadian domestic assets which may constrain their future growth.

In the European Communities: New draft banking directives and harmonization requirements may require discriminatory disclosure of individual branch balance sheets from non-E.C. banks.

France: French financial institutions with minority foreign ownership will be nationalized. Fair compensation has yet to be determined.

There are actual problems

In Australia: There is prohibition on foreign banks establishing branches or banking subsidiaries which effectively excludes them from taking local deposits or providing foreign exchange services.

Brazil: Since 1964, no additional U.S. banks may establish branches or banking subsidiaries and banks already present may not open new offices.

Mexico: Foreign banks are prohibited from establishing branches or banking subsidiaries. Activities of existing offices are severely restricted.

South Korea: Foreign banks' access to local currency is limited by their inability to issue CDs. Inability to own

	real property limits their ability to lend on a secured basis.
Sweden:	Foreign banks are prohibited from establishing branches or subsidiaries.
Taiwan:	Foreign banks' access to local currency is severely limited by a ban on accepting time deposits, a ceiling on demand deposits, and denial of access to the central bank discount window.
Venezuela:	Foreign banks are prohibited from establishing retail branches or subsidiaries. Activities of existing offices are severely restricted.

The above list is illustrative and not exhaustive. It would be unfair and unjustified for the government to claim full credit for the progress that has been noted, but the U.S. does have a record of having made our views known to the foreign governments concerned, with more emphasis in some countries than in others; obviously we are delighted when progress is made.

How do we plan to proceed?

In attempting to encourage countries to remove restrictions on the ability of American banks and securities houses to compete for local business, progress is often frustratingly slow. To a degree, cross border lending and liberalization of capital movements help to achieve internationally what sometimes cannot be achieved directly in a domestic market. For example, sometimes a foreigner has been free to purchase securities in the New York market, but a U.S. securities firm could not actually solicit the business in the foreign market. Currency restrictions are another major form of impediment. We tend to find more difficulties in the developing countries but several OECD countries still maintain exchange controls.

We in the Treasury working closely with the Federal Reserve Board and the Office of the Comptroller of the Currency try to make progress through on-going bilateral discussions with the finance ministries and central banks concerned, aimed both at obtaining greater liberalization of capital movements and national treatment for U.S. banks and securities houses operating in the major overseas markets. As noted, we are in close and frequent contact with U.S. banks, securities firms, trade organizations and financial institutions. We attempt to assess the type of problem faced by U.S. banks abroad. Some of these are the international, cross border type; others appear to be purely domestic market activities, not falling into the traditional definition of foreign trade.

We raise these problems during our bilateral meetings with senior foreign Government officials. We often use our embassies abroad; we have Treasury representatives based in the U.S. Embassies in major overseas financial centers who have a close and continuing professional relationship with the finance ministries, central banks and regulatory agencies in those countries. They frequently present our views and report reactions.

In general we try to convince foreign governments of the advantages of developing a modern and sophisticated financial sector. We are now stressing reforms of financial structures in Less Developed Countries (LDCs) as part of our bilateral and multilateral aid programs in order to foster the growth of domestic savings and investment. This in turn works towards a more favorable climate for the entry of U.S. banks and securities firms. The issues involved are often complex; it is very hard to construct a scorecard and often a change in economic climate or a worsening balance of payments can bring on the reimposition of exchange controls which cut across our efforts, however justified the measures may seem to the country concerned.

We make our views known at IMF/IBRD meetings, as well as at OECD sessions that bring together cabinet and sub-cabinet financial officials. We also attach considerable importance to the on-going work of OECD specialized committees which deal with capital movements and financial markets, and the OECD Codes of Liberalization of Capital Movements and Invisible Operations. These Codes help provide a framework for progress and for meeting agreed commitments; unfortunately, for the most part, they do not provide for the right of establishment.

Given the variety and uniqueness of the problems encountered, it remains to be determined how -- or if -- U.S. objectives in the area can be made to fit into a more ambitious overall approach on services. For the moment, our efforts are both bilateral and multilateral, using existing OECD committees and at the higher policy level, making persuasive efforts in the IMF, IBRD and OECD context.

Our aim is pragmatic; to continue to work wherever and however we can for national treatment, although the problems of obtaining such treatment differ country by country and do not lend themselves readily to harmonization or precise codification. Questions of right of establishment may need to be considered in a somewhat different context.

In the overall framework of our efforts, the Treasury believes that continued efforts to address specific problems in areas of interest and importance to U.S. financial institutions is the approach most likely to yield positive results. Steps in the direction of a larger international framework of trade in banking and related services may be possible, but also would be very time-consuming to negotiate and of untested value. I should note that the European Communities, which have an agreed mandate to work towards harmonization of banking regulation, have found the process thorny and much more difficult than initially envisaged. A more targeted and limited multilateral agreement on key principles such as national treatment and transparency of regulations may provide a feasable option for the broader services exercise, of which banking might be a part.

We intend to work closely with the U.S. banking and investment industry in identifying problem areas and working towards satisfactory solutions. I assure you that our objectives and initiatives, whether bilateral, in existing multilateral fora, or in the context of even wider negotiations on services, will continue to reflect your and our own deep desire to work towards national treatment for U.S. financial interests overseas.

Senator **Heinz**. Mr. Secretary, thank you very much. In the report that the Treasury Department issued about 3 years ago, following from the mandate of the International Banking Act to prepare it, there are three recommendations that start on page 435 of the report.

ACCURACY OF REPORT QUESTIONED

The first one starts out with the following sentence: "Since U.S. banks generally receive equitable treatment abroad, remedial efforts should be directed to areas in which U.S. banks do not receive national treatment of competitive quality." The operative observation to which I would draw your attention is that which claims that U.S. banks generally receive equitable treatment abroad. Now, the General Accounting Office has looked at that. They apparently interviewed some people within the Treasury who disagreed very strongly with that conclusion. Are you one of them?

Mr. **Leland**. There are several elements to that question, Mr. Chairman. First, when I looked into this, I couldn't find anyone in the Treasury who had said we didn't have problems in the banking area abroad. I don't think anybody made any specific comment to that effect. As I understand it, the GAO itself has not put its own name on the report in question because there may be disagreement as to its accuracy.

And the Treasury itself never disagreed that there were problems. I think there was a misunderstanding. I think what one wants to do, however, is to emphasize where progress has been made, and can be made. I think there are other areas where the problems may be even greater. Our banks, as Ambassador Brock pointed out, are very strong, powerful, and effective. We have the best banking system in the world, really. And it is in a lot of markets.

What we are concerned with is fair treatment. As I mentioned in my statement—and this is true for banking but is not true in a lot of other services—banks can send a representative into a country and as long as he's allowed in and treated fairly, the actual transaction can be carried out somewhere else. And this can accomplish much the same objective.

I think a lot of the discussion of that report had focussed on emphasis, but, as I pointed out in my statement, there are a lot of countries—and you can't deny it—where there are problems: Australia doesn't allow our banks in, Brazil hasn't allowed one since 1964. Mexico, we're back 20 years. Banks which were grandfathered may be happy, but the others aren't. South Korea and Sweden don't allow any branches. Taiwan is starting to make some moves, possibly, to do something, but they haven't been very good. And Venezuela.

So our view is not that there is no problem. But I think that there are major markets where we are not unhappy.

Senator **Heinz**. I think that's the important point. Because in your testimony, you do stipulate a number of problems, and potential problems, and areas where we have taken action. And you wouldn't take action unless there were a problem.

My concern with the Treasury Department study is that it invites an attitude of complacency. I am glad to hear you don't share that.

Mr. LELAND. I definitely don't share that.

Senator HEINZ. There are some people who feel that when foreign banks come to this country to establish themselves that our bank regulators just welcome them with open arms and never pay any attention to the conditions in the country of their national origin; and that they might better use the opportunity, when a bank comes to this country, to say, "Fine. We don't mind having you here, but we would like better national treatment in the country in which you're domiciled."

Do you believe that that is a fairly accurate reflection of the current situation that our regulators—just saying, look at our laws, and as long as people are doing fine and promise to abide by our laws, when they're banking here, they'll just say, "Fine, come ahead. We don't really much care whether you prohibit U.S. banks from engaging in banking in your country"?

Mr. LELAND. I don't think it's fair to say we don't care. We do not have—and I think that is in both Ambassador Brock's and my statements—we do not have a specific reciprocal philosophy in this area, but we are concerned.

The major concern, which is something both the administration and the Congress have been looking at and is a concern of mine—and a concern, I am sure, of the Treasury in general—is that foreign banks might be favored over our domestic banks, which our own domestic legislation has done for a long time. I think that is being taken care of.

Senator HEINZ. Oh, they are still favored.

Mr. LELAND. Yes. In a sense. And again, the proposed legislation will start to take care of that. Maybe more has to be looked at.

The other problem with being strictly reciprocal is that it may not work—to some degree, foreign countries are shooting themselves in the foot. We don't want to make the same error. We have built up the largest banking and financial community in the world. Part of that is because all banks can come here and do business. That provides jobs, and people do things in our economy that they don't do in theirs. So we don't want to give any impression that we want to close off our market—which would hurt ourselves.

Senator HEINZ. That wasn't really my question, as to whether we should do that or not. I don't know that anybody advocates what you might call mirror-image reciprocity. I think that would be very impractical. It might very well result in shooting ourselves in the foot, given our propensity not only to do that, but to reload and quickly fire again. We might end up walking around on our hands before long.

What I would like are your views on whether we should ask our bank regulators—who make the decisions on foreign bank entrants on a case-by-case basis to make sure they're going to be good banking citizens of the United States, whether we should ask our regulators—to look at the question of reciprocity or equality of national treatment, and take at a minimum a slightly more aggressive role.

Mr. **Leland**. Put that way, Mr. Chairman, I think one has to a degree, to agree with that. Obviously, to a degree, if you're going to get changes, particularly toward national treatment within these countries, you have to use the weapons that are at your disposal—but being careful, as I said, not to make it appear as a mirror image.

Senator **Heinz**. Is it your impression that we do not ask enough of our bank regulators in this country in that regard? Should we establish the intent of Congress toward the Fed and the others who control this that we would like them to be a little more concerned and more aggressively involved, in requiring their counterparts in other countries?

Mr. **Leland**. I don't think we need that at the moment. I am not saying that at some point in working with these people we're not going to need it. That really isn't the problem. But I think at this moment we have got enough mechanisms, multilateral and bilateral, to work on these people, to try to show them the advantages of national treatment, that we don't yet need to get into something like that.

As I said, we have got such a panoply of banking laws—both State laws and Federal—it might to some degree be impractical to do it.

Senator **Heinz**. You're not, as I recollect your statement, a great optimist on the multilateral negotiations that Ambassador Brock discussed with us a few minutes ago, on the need to achieve a great deal of progress in this area?

Mr. **Leland**. Ambassador Brock and I were talking about two somewhat separate things. In certain areas of services, the answer may be that you may be able to do a lot in multilateral fora. Others, because of the wide variety of different regulations for different reasons, like banking, are going to be more difficult.

I am an optimist in some areas. And I guess it isn't a question of optimism; it's a question of how useful it would be to pursue certain lines of opportunity, as against others.

Senator **Heinz**. Last year—I guess it's now the year before last—I offered an amendment to put a moratorium on foreign bank takeovers of U.S. banks above a certain size. And I did that in order to get the Fed, the Comptroller, the GAO, and others to study and have the time to study what I saw as a growing trend; namely, the impetus of foreign interests to acquiring very large U.S. banks.

Now, in this country, we have a rather interesting central banking system compared to other countries. Our central bank is not just the Fed. It is the Fed and other large, privately owned and operated banks that function as the so-called clearinghouse banks. Together they really form the central banking system of this country—as opposed to just thinking of that system as the Fed. I haven't run into anybody who feels that it would be good for this country to permit the acquisition by foreigners of a majority—let alone a substantial number—but a majority of our so-called top 10, our clearinghouse banks.

Would you feel it was somewhat dangerous to permit foreign interests to control or acquire, let us say, a significant number of our top 10 banks, our clearinghouse banks?

FOREIGN TAKEOVERS

Mr. **Leland**. As you have it now, I think you're getting up to something over 12 percent of our banking system being owned by foreign interests. That, to me, is not a damaging percentage. True, as I said, we're very much concerned by the fact that a foreign bank can come in and take over one of our banks when another domestic bank can't. And that really doesn't make a lot of sense.

As a general view, I don't see that there is a great threat of foreign banks coming in. I think, clearly, the Fed is still the central bank. It makes the rules and regulations by which any bank, foreign or domestic, has to abide. So at the moment I don't think it's of great concern.

Obviously, if I saw the situation of our banking system being predominantly foreign owned, it's something we'd have to look at.

Senator **Heinz**. Two of our top 15 banks are now foreign controlled. Marine Midland and Crocker. Would you begin to worry when it's three, four, or five?

Mr. **Leland**. It's something we have to watch. As far as I know, there is no prospect of any others being purchased.

Senator **Heinz**. Two years ago there was no prospect of the Crocker Bank being controlled by somebody else. You don't know when these are going to take place.

Mr. **Leland**. The Crocker Bank——

Senator **Heinz**. I mean, we're living in a very rapid fire age of corporate takeovers. Witness Conoco, Marathon Oil. There's a lot going on out there. It happens overnight.

Mr. **Leland**. That's why I say you have to watch it. You have to balance competing interests, because I think the argument is fair, possibly, that in those cases—like Crocker, with the new capital that's going to be put in it—that it's going to create more jobs and will become stronger internationally. And whether or not this happens, it will still be a strong domestic bank. If one's concern is whether or not to any degree it would not be operating in the same fashion, owned by a foreign owner, than it might be by a domestic owner, that's something I think we have to look at.

Senator **Heinz**. One of the differences between U.S. bank regulations and foreign bank regulations is that we tend to have in this country fairly conservative, fairly demanding capital ratio requirements. In other countries, those ratios, I'm told, are much smaller. The banks are leveraged much more aggressively. Sometimes that's possible because of the tremendous support that the government, the central banking system of that country, gives those banks. Literally, those banks are underwritten as a result. Does it appear to you that banks of that kind of national support are going to have an unfair competitive advantage when they do business here?

Mr. **Leland**. I think there obviously are differences. To some degree, that's a possibility.

Senator **Heinz**. Thank you very much, Mr. Secretary. We appreciate your being here.

[Answers to additional written questions follow:]

ANSWERS TO QUESTIONS FROM

DEPARTMENT OF THE TREASURY

1. Question: Do you believe that there is a significant conflict between the current U.S. policy of non-discrimination -- which attempts to accord equal competitive opportunity to foreign and domestic banks irrespective of U.S. bank treatment abroad -- and the policy of reciprocity advocated by various states -- which requires that a foreign bank applicant be able to demonstrate that its country permits equivalent treatment to U.S. state-chartered banks?

Answer: Prior to the passage of the International Banking Act of 1978, entry by foreign banks was largely governed by the states. The IBA created a national policy for entry of foreign banks, providing for the establishment of Federal branches and agencies with the approval of the Comptroller of the Currency. The absence of reciprocity provisions in the approval process does leave some potential for conflict. However, reciprocity would not promote the development of the United States as the major international financial market. Restrictions on admission of foreign financial institutions work against that aim. As I remarked in my earlier testimony, the President has stated, "My own Government is committed to policies of free trade, unrestricted investment and open capital markets." I noted in the testimony that a policy of reciprocity "could well be a step towards protectionism rather than a movement towards greater liberalization. "Since this question is presently sub judice with respect to approval of certain Federal branches and agencies, the Treasury Department is unable to discuss it in detail. However, as indicated below, Treasury does attach considerable importance to reduction of foreign countries' restrictions on the entry and operation of U.S. banks. Also, most countries of interest to U.S. banks do grant national treatment to a large extent, and most states having reciprocity provisions interpret them liberally.

2. Question: If bilateral negotiations to reduce foreign barriers to our banking services were undertaken, would it be very difficult to reach an agreement because of the mixed jurisdiction between Federal and State governments and the diffusion of chartering and regulatory authority? Do you consider this a formidable handicap in negotiations?

Answer: The U.S. objective in any bilateral negotiations to reduce foreign barriers in banking will be to achieve national treatment in foreign markets, as we now provide under Federal regulations for foreign banks operating here. The Federal Government clearly cannot make commitments which would limit the powers or discretion of state governments in their area of jurisdiction. (The best the Federal Government can do is to promise to use moral suasion to urge state governments to live up to any Federal commitments.) Should any U.S. concessions be made, they would be in areas covered by Federal legislation since these embody the kind of restrictions which foreigners find most onerous. We therefore do not think that the diffusion of chartering and regulatory authority in the United States would be a major issue in these negotiations.

3. Question: What do you believe are the best bilateral and multilateral alternatives available for the effective removal of barriers to U.S. banks operating abroad?

Answer: The best bilateral avenues are likely to be formal and informal contacts between the Treasury Department and finance ministries of the respective countries. Such contacts should -- and in fact do -- take place at various levels, up to and including the level of ministers. The Treasury of course works closely with the Federal Reserve and Comptroller of the Currency, and these entities have contacts with their foreign counterparts which may be used to complement discussions in finance ministry channels. We coordinate with our embassies abroad; in major overseas financial centers our embassies include Treasury representatives who have a close and continuing professional relationship with the finance ministries and the agencies responsible for banking in the countries where they serve.

The primary multilateral forum, if a multilateral initiative were considered advisable, would probably be the Organization for Economic Cooperation and Development (OECD). One of its specialized committees, the Committee on Financial Markets (CFM), exchanges information on developments in banking laws and practices in the 24 OECD member countries. While the CFM is a consultative body, it would probably be the most appropriate OECD committee for carrying the main responsibility for any multilateral discussions aimed at reducing specific barriers to the establishment and operation of foreign banks in OECD countries. Another OECD committee, the Committee on Capital Movements and Invisible Transactions (CMIT), might also play a major role. The CMIT oversees the OECD Codes of Liberalization of Capital Movements and of Current Invisible Operations; they could serve as the framework for giving legal force to any multilateral agreement concerning establishment and domestic operation of foreign banks in an OECD member country. Other OECD committees might also have a useful role to play, including the Committee on International Investment and Multilateral Enterprises and the Trade Committee. There may also be the possibility of treatment of services issues in general within the GATT, through expansion of the GATT Codes on nontariff barriers to trade. In addition, a more targeted and limited multilateral agreement on key principles such as national treatment and transparency of regulations may provide a feasible option for the broader services exercise, of which banking might be a part.

It should be noted that only a few OECD countries have restrictions on banking that pose problems of significant concern, and some of these countries are moving toward more liberal practices. However, it would be easier to develop the principles of any multilateral agreement in this forum than in a broader one, and they could serve as a common basis for approaching non-OECD members.

4. Question: What issues do you see on the horizon that could jeopardize the ability of U.S. banks to play an active role abroad? Are there any particular problem regions, such as the Middle East, where I understand there is a growing trend towards nationalization?

Answer: The overall ability of U.S. banks to play an active role abroad is not dependent upon access to any one country. Most overseas banking business entails transactions that can to a large extent be conducted "offshore," without a physical presence in the country of the customer. For instance, two-thirds of the claims and liabilities of foreign branches of U.S. banks are booked in London, the Bahamas or Cayman Islands, but only one-fifth of the claims and liabilities of the branches in these three countries are held vis-a-vis residents of that country. For branches in the United Kingdom alone, this ratio is about one-third. (These ratios do not reflect any transfer of business to International Banking Facilities, which can be established in the United States as of December 3.) Nevertheless, U.S. banks do stand to gain from physical access to countries and to local deposit markets, particularly if they wish to do any retail business.

The extent of the negative impact on U.S. banks of foreign barriers depends on the size and nature of the market from which they are excluded or in which they cannot operate on a basis equivalent to that of indigenous banks. In major markets, U.S. banks are for the most part able to operate without undue constraints, although they may be unable to compete over a full range of financial services. Restrictions are more widespread in those markets -- generally in less developed countries -- of lesser interest to our banks and in the newly industrialized countries. Some of these countries have sought to transfer ownership of foreign banks' subsidiaries in the country to their nationals, but these efforts have not resulted in inadequately compensated takeovers. Nationalization of banks in less developed countries (i.e., assumption of ownership by the government) has in recent years been relatively rare, since the goverments of these countries have little to gain -- net worth is relatively small, and there are generally other means of controlling banking operations -- when measured against the resulting loss of expertise and ready access to foreign funds.

Among developed countries, the recent decision of the Government of France to nationalize indigenous banks that were not already owned by the public sector affects only those few U.S. banks which have a minority interest in a French bank. (Majority owned subsidiaries of foreign banks, as well as branches, are exempt from the nationalization measure.) These U.S. banks are concerned over the adequacy of compensation offered, and the U.S. Government is in touch with the French Government on the matter. We will also be monitoring the longer run impact of changes in the French banking system on the competitive position of U.S. banks.

There are two other areas which we will be following closely. One concerns efforts by the European Communities to move toward common standards for EC bank chartering and operations. We will want to assure ourselves that these efforts do not discriminate against non-EC banks. Another area is restrictions on crossborder data flows; such restrictions have the potential for posing severe impediments to banking transactions and merit careful attention.

Although Question #4 is directed at potential foreign developments, the continued ability of internationally-oriented U.S. banks to operate abroad will also be a function of their overall strength in domestic markets. We will need to keep the domestic regulatory environment in tune with the evolution of banking practices and to ensure that our banks continue to operate in a safe and sound manner.

5. Question: What is the Treasury doing now that was not done during the Carter Administration to reduce barriers to U.S. banking abroad? Are there any new initiatives?

Answer: This Administration has signalled its intention to enhance efforts to reduce barriers. Treasury is devoting considerable time and effort to following up on the instances of non-national treatment that are identified in the 1979 Report to Congress on Foreign Government Treatment of U.S. Commercial Banking Operations and in other sources. Policy level officials are taking a personal interest in specific cases -- involving all types of financial institutions. We are at present seeking to ascertain the relative importance of various problem areas, through intensified contacts with the banking community, with the aim of raising the more significant ones in the course of bilateral conversations with appropriate foreign officials. Specifically, we have strengthened the Treasury's working relationship with the Bankers Association for Foreign Trade, the American Bankers Association and the American Banks Association of London, seeking their help in identifying and assessing international barriers. We are also considering how banking and other financial services could best be handled within the broad efforts underway by the U.S. Government to achieve greater liberalization in international trade in services.

6. Question: A large part of the problem lies with restrictions to trade by the developing countries. The multilateral financial institutions, such as the IMF and the World Bank, examine a country's economic policies in making its conditions for receiving assistance from these organizations. To what extent are barriers to service trade examined?

Answer: The reduction and elimination of restrictions on international trade and payments is an explicit and primary objective of the International Monetary Fund (IMF). The IMF Articles of

Agreement, which each member accepts upon joining the institution, provide (Article VIII) that "no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions" (which includes services). The Articles recognize, however, that some countries may have difficulty in completely fulfilling these obligations at the time membership begins, and provision is made (Article XIV) for a "transitional" period during which restrictions on current transactions may be maintained, subject to annual consultations with the IMF.

In practice, most developing countries have maintained such restrictions under Article XIV status for extended periods. In the annual consultations with these members, the IMF seeks to encourage the adoption of economic policies that will permit the reduction or elimination of restrictions. In addition, the IMF normally requires that a member using Fund resources not intensify, and wherever possible reduce, such restrictions. Finally, an annual IMF *Report on Exchange Arrangements and Exchange Restrictions* focuses on recent developments and provides a detailed summary of the practices in individual countries.

In general, the efforts by the IMF over the years to promote an open system of trade and payments have been very successful. The adoption of a multilateral system of exchange and payments and the reduction of restrictions have been major factors in the growth of international trade in goods and services and capital flows on which global economic prosperity depends. The World Bank, too, is supportive of an open trading system and competitive international markets in services as well as goods. In its overall analysis of a country's economy, the Bank reviews policies relating to service as well as merchandise trade, along with the general macroeconomic policies of a government. It is the stated policy of the World Bank that trade barriers lead to an inefficient allocation of resources and are damaging to economic development. The role of the World Bank in this area has intensified recently with the introduction of structural adjustment lending.

The above description concerns only restrictions of an exchange control nature imposed on international services payments. While such transactions are an essential aspect of trade in services, the ability of services industries to establish themselves and transact business on a national treatment basis in a member country of the IMF or World Bank is not a matter that is scrutinized by either entity.

Senator **Heinz**. We have a panel of witnesses whom I would like to have come forward. Our four witnesses are Joan Spero of American Express, Donald McCouch, of Manufacturers Hanover, Henry Parker of the U.S. Chamber, and William Fishman of Sullivan & Worcester.

Ms. Spero would you please be our leadoff witness on that.

STATEMENT OF JOAN E. SPERO, VICE PRESIDENT, INTERNATIONAL TRADE, AMERICAN EXPRESS CO.

Ms. **Spero**. Thank you, Mr. Chairman.

My name is Joan Spero. I am a vice president in the office of corporate strategic planning at American Express Co.

I am pleased to be present today to discuss trade barriers confronting service companies and to propose some concrete measures to address some of these issues. I would like to submit my full testimony, if I may, for the record.

Senator **Heinz**. Without objection, all your testimony will appear on the record.

Ms. **Spero**. Thank you. I will summarize my major points.

Mr. Chairman, the United States has become a service sector economy. The statistics that I have on the charts that I have brought with me today demonstrate the significance of the service sector at home and abroad. With your permission I will turn to them.

The United States is the world's major service economy. Even if we exclude Government services, 51 percent of our gross domestic product is derived from services. It is also interesting to note that our closest competitor in terms of GDP derived from services is Japan. This pie chart demonstrates the role of services in the U.S. gross national product. Sixty-six percent of the U.S. GNP is derived from services. If we exclude Government, we see that about 54 percent of the U.S. GNP is accounted for by private sector services.

Service sector employment similarly is also very significant. This chart shows nonagricultural employment in the United States. In 1981, about 72 percent of U.S. employment in the nonfarm sector was accounted for by service industries. Contrary to many myths the service sector is also characterized by high productivity. This graph shows the growth in productivity in the service sector as compared to the growth of productivity in the goods producing sector. We see that from 1967, the base year used by the Department of Labor, until 1979, the year of our most recent statistics, productivity in the service sector increased by 20 percent, while productivity in the goods producing sector increased by 10 percent. Productivity growth in the services sector was twice as high as productivity growth in the goods producing sector.

SERVICES IN U.S. INTERNATIONAL TRADE

I come, finally, to the subject of the hearings for today: The role of services in U.S. international trade. This table comes from a study that was commissioned by the Departments of Commerce and State, and by the U.S. Trade Representative's Office. It is the study to which Ambassador Brock referred today. The study was an effort to learn how much income in the United States derived from service exports in the year 1980. The number they came up with was $60 billion in export services in 1980. This is a ballpark figure, an estimate. But it is much higher than earlier figures. Another interesting thing to note in this table is the industries which contribute to these exports. You find not only banking and insurance the industries that one would expect, but also education services, temporary employment, and health services industries that one does not normally think of as major exporters.

Finally, this graph attempts to show the role of services in the U.S. balance of payments. As you can see in the service sector, the balance of payments has been positive and growing rapidly whereas in merchandise trade, as we all know, we have been experiencing a deficit.

Mr. Chairman, for the moment, the United States is the No. 1 exporter of services in the world. We account for approximately 20 percent of total world trade in services. However, our position is being challenged. Increasingly, we are encountering trade barriers which other countries have erected and continue to expand. You will be hearing more about the seriousness of these barriers from the other members of the panel this morning. The time to rectify the situation is now.

As the statistics I have just shown indicate, the importance of services can no longer be ignored. It is time to recognize economic reality and to incorporate services into our domestic and international policy.

Mr. Chairman, let me emphasize that a policy to promote services should not come at the expense of manufacturing and agriculture. Indeed, evidence that we have shows that there is a synergistic relationship between the growth of the service sector and the growth of these other sectors. What I would like to focus on are some concrete actions that can be taken now to maintain and improve the vitality of the service sector.

ACTIONS TO IMPROVE SERVICE SECTOR

First, the Service Industries Development Act, sponsored by Senators Pressler and Inouye, has just been introduced in Congress. The main purpose of the Service Industries Development Act is to "promote the competitiveness of U.S. service firms." This legislation mandates the U.S. Government to fully recognize the service sector in its policy development. It also provides the resources for the development of adequate statistics for the service sector. You have heard from a number of witnesses this morning of the importance of this statistical base. This bill is not controversial. It does not cost money. And it is important. It should be passed by this Congress.

Second, Congress must also address U.S. laws affecting trade in services. In particular, the Trade Act of 1974 must be expanded to adequately address service sector needs and to define remedies applicable to service companies. Several areas in the law, in our view, require improvement.

First, we need a clear statement of congressional intent that service sector trade be viewed as an important and integral part of U.S. trade policy.

Next, in both bilateral and multilateral trade negotiations, the U.S. Trade Representative and other responsible officials should be required to take account of service sector interests in markets of the foreign countries involved and be required to seek service trade concessions in the negotiations.

The fair trade laws should be amended so that they encompass service sector problems such as dumping and subsidization of services.

The authority of the President should be clarified under section 301 of the Trade Act to impose restrictions on the services industries of countries that discriminate against the U.S. service sector activity in their markets.

And last, in determining foreign access to U.S. markets, Federal regulatory agencies should be required to consider the position of U.S. service interests in the relevant foreign markets.

A legislative proposal to amend the Trade Act is now being drafted by a committee of the chamber of commerce. Once this proposal is ready, it should be carefully examined, and once introduced, there should be expedient hearings on the issues. While this legislation would fall under the jurisdiction of the Finance Committee, the problems it addresses are at the heart of the issues we are discussing here today.

Third, Mr. Chairman, on the international side, we must examine proposals for multilateral negotiations on trade in services. One such proposal has been made by the International Chamber of Commerce. American Express was active in the drafting of this proposal, and I would like to request that the proposal be submitted for the record.

Senator HEINZ. Without objection, so ordered.

[The information follows:]

[Document No. 103/34 Rev. 4]

INTERNATIONAL CHAMBER OF COMMERCE COMMISSION ON INTERNATIONAL TRADE POLICY AND TRADE-RELATED MATTERS—POSITION PAPER ON LIBERALISATION OF TRADE IN SERVICES

Statement adopted by the Commission. At its meeting on 30 September, the Executive Board of the ICC granted the Secretary General advance authorization for the immediate release of this document.

1. In almost all industrial countries and in much of the developing world the service sector has significantly increased in importance over the last thirty years. By 1978 the contribution of the service sector to Gross Domestic Product was at least as important as that of the industrial sector for nearly all GATT contracting parties, and its importance as a source of employment increased accordingly. As with merchandise, a large part of this service activity does not give rise to international transactions, but in many industries international business has also greatly expanded, and now represents a considerable share in trade flows. Between 1967 and 1975 world trade in services increased by about 6 per cent per annum in real terms, and by 1975, exports of services represented over 20 percent of total exports of goods and services for all countries.

2. Much of this service activity is not conducted purely for its own sake, but is also an essential adjunct to international trade in raw materials and manufactured goods. Though many of the impediments to a free flow of goods have been removed or significantly reduced by the rounds of multilateral negotiations under the auspices of the GATT, many service industries, including, for example, not only the more traditional areas of construction and engineering services, insurance, banking and financial services, legal and medical services and transport, but also tourism, franchising, information and data services, leasing and consultancy, still confront severe government-imposed obstacles to their international operations. These restrictions not only reduce the efficiency of services trade, but also produce unfair

competition among the service industries of different nations, and introduce cost distortions into trade flows of goods. At present these restrictions cannot always be identified or remedied. This partly because as yet there does not exist an agreed international standard for the treatment of services, which makes it difficult to define the remedies appropriate to resolving problems of unfair competition.

3. A progressive and comprehensive liberalisation of international trade in services is now therefore timely and necessary to reduce the present distortions in such trade. Liberalisation of services trade, permitting greater access for service industries to exercise their activities in foreign markets would act as a stimulus to international trade, and would also often have an innovative effect in local service industries and thus contribute to economic development. The International Chamber of Commerce, with members in over one hundred countries, therefore urges governments of both developed and developing countries to respect and fully implement existing agreements providing for the liberalisation of services trade, and to begin the preparations necessary for mutually advantageous negotiations to reduce impediments to international trade in services on a multilateral and, wherever possible, reciprocal basis.

4. Circumstances in individual countries and existing arrangements in some service markets will influence the pace at which liberalisation can be pursued. At least initially, therefore, the liberalisation of services trade implies: (i) that all such trade be conducted according to the principles of fair and open international competition; (ii) that internationally traded services originating from any country be subject to equal treatment by the recipient nation (the most-favoured nation principle); (iii) that, where they are not in the wider interests of the service user, restrictions on the ability to purchase services across national borders be reduced in as far-reaching and as reciprocal a manner as possible; (iv) that the above principles, and any departures from these principles which are deemed necessary during the transition to a fully liberal services trade system be subject to periodic review and negotiation; and (v) that new limitations to the international free movement of services be avoided as far as possible, and that if a situation were to arise calling for further restrictions, such restrictions be temporary and subject to prior consultation and negotiation.

5. The ICC welcomes the efforts made in a number of circles to compile information on the trade effects of restrictions on international service transactions, and on specific problems faced by individual industries. It hopes that such efforts will continue. However, the ICC believes that, in addition, it is now necessary to develop practical methods and procedures to eliminate the major impediments to international trade in services, or, at least, to greatly reduce their effect.

6. In spite of the differences in activity among the different service industries with international interests, the ICC believes that the underlying principles of liberal trade and fair competition are common to all. Thus, although the impediments to liberal trade in inividual service industries might appear different in their detailed application, it is possible to classify them as departures from these underlying principles, in terms of major non-tariff barriers to trade applying to all industries. The ICC therefore puts forward such a classification, which is not exhaustive, which might profitably be used in conjunction with the data at present being compiled in several quarters to develop a framework of obstacles to trade in services which would then serve as a basis for a negotiated liberalisation of this field. (This classification is included as an annex to this document).

RECOMMENDATIONS FOR ACTION

7. In the long term, any effective and comprehensive liberalisation of international trade in services must be conducted on a multilateral basis. The extension of the GATT to include trade in services represents the most effective method of achieving this liberalisation for the following reasons: (i) International trade in goods—which is already covered by the GATT—and international trade in services are governed by the same underlying economic principles, and in many cases the impediments involved—subsidy and regulatory practices, government procurement procedures, technical standards and licences—are similar. The impediments which are more specifically related to trade in services can still be regarded as non-tariff barriers, and should be tackled in a similar manner to the non-tariff barriers discussed during the Tokyo Round; and (ii) The application of the most-favoured nation principle espoused in the GATT ensures that the benefits from liberalisation will accrue to all nations.

8. The ICC therefore calls upon all governments to accept that the principles espoused in the GATT system for the regulation of world trade be extended to cover trade in services, and urges them to begin preparations towards multilateral negoti-

ations to reduce existing impediments to international trade in services and to create an accepted framework for the conduct of liberal trade in services. There have been proposals for a Special Session of the GATT Contracting Parties in 1982, at which trade in services would be one of the items for discussion, and this initiative is welcomed by the ICC. The classification of non-tariff barriers to trade in services set out in the annex demonstrates that many of the obstacles to services trade are similar in principle for many industries (eg. the existence of subsidies which distort competition, administrative impediments to operation, etc.) and it is therefore possible for the principles of a liberal framework for services trade to be negotiated on an overall multilateral basis, in a similar fashion to the negotiation of the principles espoused in the Codes on non-tariff barrier agreed during the Tokyo Round. This is but a first stage, however, and does not imply that the application in practice of the regulatory measures required for liberalisation will be necessarily of an across-the-board character, as in certain instances the regulation resulting from negotiated agreement on the basic principles for liberalisation will have to be tailored to meet the specific operating characteristics of the different industries involved.

9. However, the acceptance that the principles espoused in the GATT should be extended to cover trade in services does not imply the exclusion of other fora from this process of liberalisation in the short-term. Important work for trade in services has already been undertaken in other circles, notably the Declaration and Decisions on International Investment and Multinational Enterprises adopted by the Governments of the OECD countries in 1976, and the contribution of agreements in such fora to the liberalisation of trade in services should not be underestimated or ignored. The ICC welcomes the initiative taken in the meeting of the Ministerial Council of the OECD of June 1981, where "Ministers expressed the wish that the ongoing OECD activities in the field of services be carried forward expeditiously. They agreed that, in the light of the results of these activities, efforts should be undertaken to examine ways and means for reducing or eliminating identified problems and to improve international co-operation in this area".

In addition, in the absence of overall multilateral agreements, a large measure of liberalisation could also be achieved in the shorter term through a series of industry-specific negotiations. Certain governments are already committed to a liberalisation of trade in services, and the ICC encourages them to enter and expand negotiations with other governments. In addition, certain industries are already regulated by inter-governmental or inter-industry agreement, and initial liberalisation measures might be negotiated using the existing regulatory institutions.

10. The ICC fully recognises that an overall multilateral agreement will require a lengthy period of comprehensive preparation. Therefore, it recommends two specific issues which might be tackled immediately to produce solutions in the near future as a first stage in the progressive liberalisation of services trade. These recommendations do not imply, however, that other obstacles to services trade are not of equal importance to certain industries, and the ICC hopes that, wherever possible, advances in the liberalisation process might also be made in these other areas at the same time.

(i) *Government procurement.*—An Agreement on Government Procurement was negotiated during the Tokyo Round of Multilateral Trade Negotiations under the auspices of the GATT. The Agreement, which entered into force on 1 January 1981, contains detailed rules on the way in which tenders for government purchasing contracts should be invited and awarded. It is designed to make laws, regulations, procedures and practices regarding government procurement more transparent, and to ensure that they do not protect domestic products or suppliers, or discriminate among foreign products or suppliers.

At present the Agreement applies primarily to trade in goods, as services are only included to the extent that they are incidental to the supply of products and cost less than the products themselves. However, the Agreement specifically mentions the possibility of extending its coverage to services contracts at an early date.

The ICC therefore urges all governments to respect and apply fully the existing Agreement, and calls upon contracting parties concerned to prepare negotiations, taking into account the experience of the present Agreement, with a view to including services procurement in the Agreement, and to make the list of government entities which would be covered by the Agreement as wide as possible.

(ii) *Legal establishment and access to markets.*—The rights of legal establishment and of access to foreign markets concern firms trading in goods and services alike, but are of particular importance to many service industries, owing to the nature of their business. As a first step in liberalising services trade, therefore, it is important that governments extend national treatment for establishment and market access to all firms wishing to establish an operation within their national boundaries. This would best be achieved by means of an agreement including provisions that:

1. Where the applicant firm meets the local legal requirements for the establishment of a company in the host country (reason able allowance being made for the different legal forms under which enterprises may exist), such establishment should be freely granted.
2. The legal requirements for establishment apply equally to domestic and foreign applicants.
3. Information of such legal requirements be freely available.
4. The application procedures be implemented in a non-prejudicial manner.
5. Access to the domestic market for any firm should not be impeded by the imposition of discriminatory restrictions on the size of the firm or the level of sales.

The ICC therefore urges all governments to take up this issue and enter into negotiations to develop an international agreement based upon the principles outlined above, to permit the unimpeded establishment and participation of international service industries wishing to operate internationally.

A GLOBAL FRAMEWORK OF IMPEDIMENTS TO TRADE IN SERVICES

The following classification of barriers to services trade is based on the premise that, notwithstanding the differences in activity among the different service industries covered, the underlying principles of liberal trade and fair competition are common to all. It attempts to draw together data on obstacles to trade in services experienced in specific industries and to classify it in terms of these underlying economic principles. This classification then offers a manageable framework of nontariff barriers to trade which can be used as a model for a negotiated liberalisation to international trade in services.

1. Rights of Establishment and Access to Markets

Establishment in third countries is, in general, more important for many service industries who wish to conduct international transactions than it is for manufacturing industries, as in many cases the provision of the service relies on the existence of a local officer or outlet. However, an additional factor in the successful establishment of a local office is the ability of a firm to gain realistic access to the market in which it wishes to operate. For transport services, for instance, the ability of a vessel to put down and pick up passengers or freight in a particular area is of greater importance when considering market access than is the establishment of a local agency. Any discussion of establishment legislation questions, therefore, should cover equally both establishment legislation—"the bricks and mortar"—and freedom of access to markets. Restrictions on establishment and market access for service industries appear to be some of the most important deterrents to international trade in services for all industries.

Impediments in this category arise from the complete or partial denial of access to a market as a result of: (1) prohibition upon the establishment of local operations or upon the importation of a service by a foreign firm; (2) the operation of a system of licences, required by foreign firms before establishment or import of the services is permitted, which act as a quota upon the number or type of foreign firms granted access; (3) legislation which obliges foreign firms to operate under significantly different conditions to domestic firms, thus increasing the cost or decreasing the attractiveness of the service offered in a discriminatory manner.

Examples

Under section 1 above: (a) legal prohibition of the establishment of firms; (b) the prohibition upon foreign investment in an existing domestic industry. (c) cabotage, i.e. the reservation of a country's domestic operations to its national flag carriers; (d) limitations on the freedom to pick up or put down passengers/freight in the country concerned, or to proceed through national territory; (e) the prohibition or limitation upon the activities of brokers of services to conduct their business on international markets.

Under section 2 above: (a) procedural impediments in the granting of the licence; (b) the requirement that the foreign firm be able to offer a service materially different from those offered by domestic firms before the licence is granted; (c) licences may only cover limited activities, and those activities not included in the licence may not be practised; (d) non-recognition of professional licences to practice awarded in other countries.

Under section 3 above: (a) the imposition of cargo-sharing or cargo-allocating agreements, either in national legislation or through the forced use of certain contract clauses; (b) limitations in foreign equity holdings or on the amount of capital required for initial investment; (c) discriminatory restrictions upon the level of sales of a foreign firm; and (d) discriminatory restrictions upon the level of advertising of a foreign firm.

2. Government Economic Policy and Regulation

Although legislation is necessary to regulate certain aspects of commerce, and to further government macro-economic policies, such legislation often results in practice in barriers to international trade, as its application to domestic and to foreign firms is, in many cases, inconsistent. The legislative measures included in this category are diverse, but when brought together, they represent one of the most common and most effective impediments to international trade in services, in both the industrialized and the developing nations.

Impediments in this category arise where local government economic policy measures discriminate between the operations of domestic and foreign firms, thus providing significantly different operating conditions for the two competing groups: (1) national treatment is not extended to foreign firms; (2) government legislation effectively impedes the export of the service; and (3) the application in practice of legislation in the host country is undertaken in an effectively discriminatory manner.

Examples

Under 1 above: (a) Foreign firms often face different tax regimes to those faced by domestic firms: (i) Corporation tax is levied at a higher level on foreign firms than on domestic ones; (ii) the purchase tax on the service can be set off against the buyer's own corporation tax when domestic services are purchased, but this practice is not extended to the services of foreign firms; and (iii) in countries which have no bilateral agreements, or which do not recognize the OECD Convention on Income and Capital, the problem of double taxation arises.

(b) Credit facilities extended by governments are often unavailable to foreign suppliers, and private credit sources are often limited in their provision.

(c) Exchange control regulations which hamper the repatriation of profits or the movement of remittances, and influence the location of the service transaction.

(d) Discriminatory regulations between foreign and domestic firms with regard to contracts, documents required, etc.

Under 2 above: (a) Taxation practices applying to citizens working abroad act as a disincentive to trade and personnel movement; and (b) the extraterritorial application of domestic laws brings the service industry into conflict with the laws of foreign governments when conducting international operations.

Under 3 above: (a) The lack of easily obtainable information on local government regulations and policy measures; (b) problems in gaining access to officials, courts, etc., to file disputes or resolve problems, or the existence of biased procedures once access has been obtained; and (c) the use of technical regulations, standards, certification systems on safety, health and manning levels, etc. to discriminate against foreign firms.

3. Direct Government Intervention

In addition to their legislatory role in providing a stable legal frame work for commerce and in furthering macro-economic policy, governments in many cases directly intervene in the functioning of the market mechanism to influence market-based decisions, and to further regional, social and industrial policies.

Impediments in this category arise where the competitive position of firms operating in a market is distorted by direct government micro-economic intervention. Such intervention may be by the government itself, by government agencies, or government-controlled corporations.

Such impediments can be split into two categories: (1) government intervention which attempts to favour or improve the competitive position of certain individual firms; and (2) intervention which specifically hampers the competitive conditions of foreign firms.

Examples

Under 1 above: (a) Government grant and loan facilities offered to industry to further regional and social policies which are not available to foreign firms; (b) requirements that ancilliary activities be provided by local firms and sales organisations; and (c) the selling below cost of competitive services by local government-owned firms.

Under 2 above: (a) Restrictions on contractural freedom and the setting of prices and charges; (b) restrictions or delays in the importation of or access to equipment and utilities necessary for the operation of the service activity; (c) requirement that factors of production (land and equipment) be leased rather than pursued by foreign firms; and (d) restrictions on the employment of expatriate staff required for the operation of a local office.

4. *Government Procurement*

A further source of government-imposed barriers to trade in services arises in the field of government procurement, in which the government participates directly in the market as a purchaser of services or in the tendering of government contracts.

Impediments in this category arise where governments discriminate between domestic and foreign firms when undertaking their own activity: (1) Government procurement procedures limit government purchases or the tendering of government contracts to local firms; and (2) there is an absence of explicit procedures and regulations concerning government procurement, or existing regulations concerning procurement are not applied, allowing discretion and discrimination in procurement issues.

Examples

Under 1 above: (a) specific regulations limit purchases by government departments, local governments and state-owned corporations to certain designated firms; (b) government tenders are only offered to specific firms; and (c) contract clauses effectively control the allocation of the services (the use of FOB purchase and CIF sale clauses to regulate shipping).

Under 2 above: (a) The lack of specific regulations allows an element of preference to be introduced in awarding government contracts; (b) tenders are not openly announced, which restricts the ability of all firms to compete; and (c) the results of tendering are not published to verify the final award of the contract.

Ms. SPERO. In November 1982, GATT ministers will be meeting to examine the state of the international trade system. The last GATT ministerial launched the Tokyo round of multilateral trade negotiations. I am not proposing that this ministerial will or should launch multilateral negotiations on services. But at a minimum, services should be included on the agenda. Congress should initiate work to prepare the United States for participation in eventual multilateral negotiations. Before embarking on previous trade negotiations, the United States supported several studies which served as the basis for U.S. policy. Studies and hearings like these today are essential to the preparatory process.

Mr. Chairman, given the importance of the service sector today and the even greater role it will play in the future, the time to begin these and other efforts is now.

Thank you. I will be happy to answer any questions.

[Complete statement and answers to additional written questions follow:]

STATEMENT

OF

Joan E. Spero
Vice President - Trade
American Express Company

on Behalf of
The American Express Company
and
The Council of the
International Chamber of Commerce

Mr. Chairman and distinguished members. My name is Joan Edelman Spero and I am a Vice President in the Office of Corporate Strategic Planning, American Express Company. I am pleased to be present today to discuss trade barriers confronting service companies and to propose some concrete measures to address some of these issues.

The United States has become a service sector economy. The service sector is one of the most dynamic components of U.S. economic growth and international competitiveness. It is time for us to recognize this reality. It is time to develop policies which maintain and improve the vitality and competitiveness of the service sector.

A policy to promote services would not come at the expense of manufacturing and agriculture. Indeed, evidence shows that there is a synergistic relationship between the growth of the service sector and the growth of these other sectors. Manufacturing and agriculture depend on a dynamic service sector -- on banking, insurance, and transportation, for example.

We must recognize the fundamental change in our economic structure and actively incorporate services into our domestic and international policy. We must begin now, not tomorrow or next year.

The data we have on services is seriously inadequate for precise analysis. Yet the statistics that are available decisively demonstrate the significance of services both at home and abroad.

- CHART I: The U.S. is the world's most important service economy. Even if we exclude government services from the service sector, 51% of our nation's gross domestic product is derived from services.

- CHART 2: The value added to the U.S. gross national product (GNP) by service-producing industries in 1979 (the latest year of complete figures) totaled 66 percent of total value -- $927 billion measured in terms of constant (1972) dollars.

- CHART 3: According to the most recent estimates of the Bureau of Labor Statistics, as of May 1981, approximately 66 million people out of a total of 92 million non-farm labor were employed in services (72%).

- If we exclude government employment, out of a total of 74 million employed by the private sector, 54 million people are employed in the service sector (75%).

- CHART 4: According to the most recent data of the Bureau of Labor Statistics, service sector productivity has grown twice as fast as productivity in the goods-producing sector. From 1967, the base year used by the Bureau, to 1979, total factor (i.e. labor and capital) productivity in the service sector increased by twenty percent while productivity in the goods producing sector increased only ten percent.

Services play a vital role in U.S. trade. Indeed, trade in services is the major trade issue of the 1980's.

- CHART 5: A study on service exports commissioned by the Departments of State, Commerce and the United States Trade Representative indicates that U.S. service exports were about $60 billion in 1980. The executive summary of this study is attached to my testimony. What is fascinating are the components of these exports. They include some industries most of us would be surprised to learn are major export earners -- for example, education services, health services and temporary employment.

- CHART 6: This last chart shows that the favorable services trade balance has grown dramatically. At the same time the U.S. has suffered a serious deficit in its merchandise trade balance. In 1980 services were responsible for the first overall surplus in the balance of payments position of the U.S since 1976. In the past decade, earnings derived from services expanded at a 19 percent average annual rate -- twice the pace of the previous decade.

For the moment the U.S. is the number one exporter of services in the world. According to the latest figures of the Committee on Invisible Exports in London, the U.S. accounted for 20% of total world trade in services. However, our position is being challenged. Increasingly, we are encountering trade barriers which other countries have erected and continue to expand.

Confronting barriers to trade in services is not an easy task. It is both conceptually and practically difficult. The service sector encompasses industries ranging from advertising and education, to banking and insurance, to transportation and tourism. Only recently have individual service industries begun to perceive themselves as part of a larger unit.

Unlike agriculture and industry, little analytical work has been done on services. Research is necessary to develop a viable data base and statistics. There must be more analysis of the theory of trade in services -- the role of comparative advantage and the common benefit of reducing barriers.

For years preceding the Tokyo Round, extensive research was compiled on non-tariff trade barriers. Similar work is necessary to determine which barriers are common to different service industries.

Problems confronting services have been characterized as "invisible barriers to invisible trade." This is a particularly apt description. Because of their "intangibility", barriers faced by exporters of services are different and more diverse than those faced by exporters of goods. The difficulties are compounded since many of the services such as banking and insurance are regulated by state and/or federal law -- causing even greater fragmentation of the issues and industry cohesion.

Personnel restrictions, national cartels and monopolies, discriminatory licensing practices and procedures, discriminatory foreign exchange restrictions, transparency, notification and due process regulations -- all reduce the ability of U.S. firms to compete abroad.

Along with these "familiar" nontariff barriers, there are a series of new problems that are a growing concern to service companies. The rapid development of computer and telecommunication technology in recent years has made information a predominant factor in the fabric of our society, policy and economy. This is one factor that cuts across all service industries -- as well as manufacturing and agriculture. Companies rely on central storage of employment records, financial transactions, credit authorizations, design work, sales coordination, inventory status -- all generated, processed and disseminated through a centralized communication network.

Pressure for regulation of international information flows is growing. It evolves from a number of different concerns: personal privacy, national security, economic development and trade protectionism. Countries have the right to pursue national economic programs and social goals, but in doing so they should act in a manner that minimizes trade distortion and barriers to free trade.

While the U.S. has some barriers, I can assure you that relatively speaking, we are a haven of free trade in services in the world. Therefore, we need to develop a regime based on reciprocity and equal treatment.

In the past, trade policy has focused exclusively on the "traditional" sectors of trade -- agriculture and manufacturing. U.S. policy is directed at promoting the export of U.S. goods and on the problems of foreign goods flowing into the domestic market -- cars, steel and shoes. This perspective must now shift to include barriers confronting U.S. exports of services. We cannot drop the traditional sectors. But we cannot afford to ignore our future.

Like our domestic policy, the international trade regime has also focused on trade in goods. GATT rules apply primarily to trade in goods, while services are included only to the extent that they are incidental to the supply of products and cost less than the products themselves. GATT multilateral negotiations have been successful in reducing barriers to trade in manufactured goods and some agriculture products. They have never even addressed services.

There have been several proposals for launching a multilateral negotiation on trade in services. Serious analysis is necessary before we can enter into such negotiations. We must examine the applicability of GATT rules and procedures to services and further explore the nature of barriers to trade in services.

Now is the time to rectify this situation. As the statistics I cited indicate, the importance of services can no longer be ignored. You have already heard considerable discussion of the barriers confronting service industries. What I would like to focus on are some precise actions that can be taken now to address this policy imbalance.

On April 9, 1981 the Reagan Cabinet Advisory Council on Trade Negotiations committed itself to giving "high priority" to trade issues relating to services and gave the Trade Representative a mandate to pursue that policy both domestically and internationally. The Cabinet announcement represented the first step in Administration recognition of the need for such a policy. This initiative must be followed by concrete action.

The Service Industries Development Act (SIDA), sponsored by Senators Pressler and Inouye, has just been introduced to Congress. The main purpose of the Services Industry Development Act is to "Promote the competitiveness of United States service firms". This legislation mandates the U.S. government to fully recognize the service sector in its policy development. It also provides the resources for the development of viable statistics for the service sector. This bill is not controversial, does not cost money, and is important. It should be passed by this Congress.

Congress must also address current U.S. laws affecting trade in services. In particular, the Trade Act of 1974 must be expanded to adequately address service sector needs and to define remedies applicable to service companies.

Changes in the trade laws are necessary for two important reasons. First, there are areas in the laws which do not adequately cover trade in services. Second, a clear legislative emphasis on trade in services would focus attention on service sector trade problems and help integrate trade in services into the fabric of U.S. trade policy.

I would like to suggest some areas in the laws governing trade in services that require improvement.

- First, we need a a clear statement of Congressional intent that service sector trade be viewed as an important and integral part of U.S. trade policy.

- In both bilateral and multilateral trade negotiations, the U.S. Trade Representative and other responsible official should be required (1) to take account of service sector interests in markets of the foreign countries involved, and (2) to seek service trade concessions in the negotiations.

- The fair trade laws should be amended so that they encompass service sector problems such as dumping and subsidization of services.

- The authority of the President should be clarified under Section 301 of the Trade Act of 1974 to impose restrictions on the services industries of countries that discriminate against U.S. service sector activity in their markets.

- In determining foreign access to U.S. markets, Federal regulatory agencies should be required to consider the position of U.S. service interests in the relevant foreign markets.

A legislative proposal to amend the Trade Act is now being drafted by a committee of the Chamber of Commerce. Once this proposal is ready, it should be carefully examined, and once introduced there should be expedient hearings on the issues. While this legislation would fall under the jurisdiction of the Finance Committee, the problems it addresses are at the heart of the issues we are discussing here today.

On the international side, we must examine the proposals for multilateral negotiations on trade in services. In November 1982, GATT Ministers will meet to examine the state of the international trading system. The last GATT Ministerial launched the Toyko Round of multilateral trade negotiations. I am not proposing that this Ministerial should or will launch multilateral negotiations on services. But at a minimum services should be included on the agenda.

Congress should initiate work to prepare the United States for participation in eventual multilateral negotiations. Before embarking upon previous trade negotiations, the United States supported several studies which served as the basis for U.S. policy. Hearings like these are essential to the preparatory process.

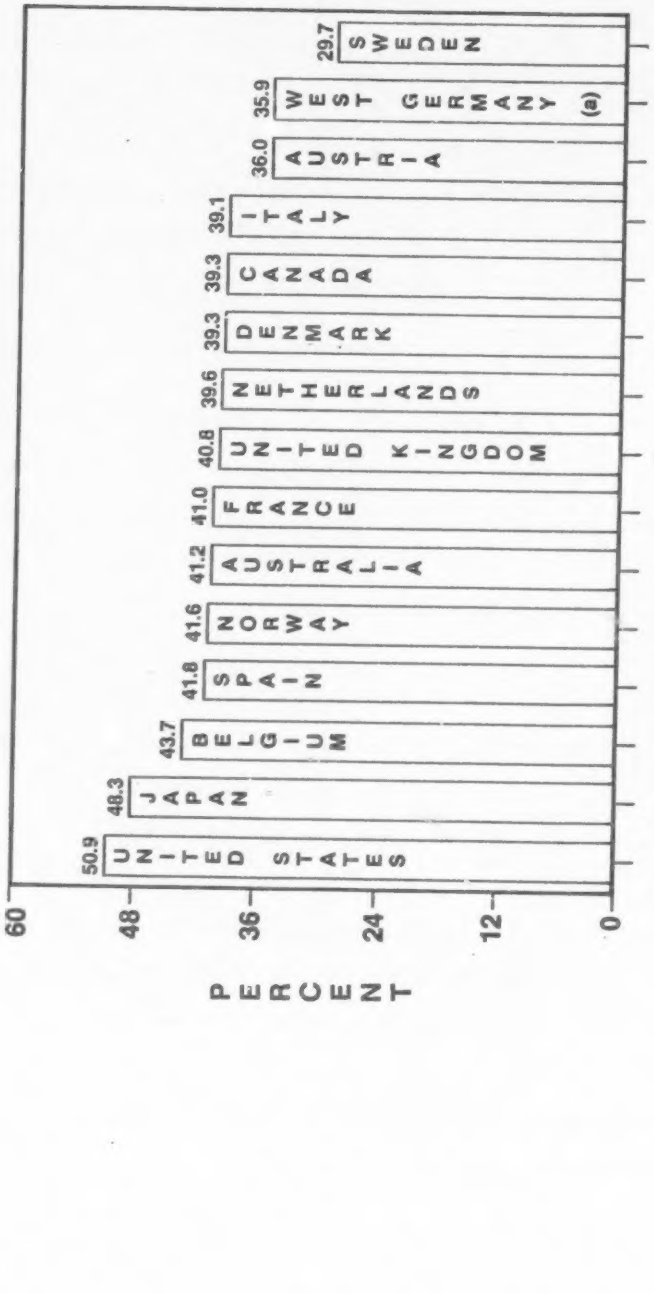
The problems confronting the service sector are not solely American concerns -- they affect all international businesses. It is in the interest of both public and private sectors to develop international awareness of these issues and to work toward establishing a coherent international framework for open trade in services.

This challenge will require a great deal of time, effort and support. By definition it will require close cooperation between business and government, between different departments and agencies of the Executive branch, and between the Executive branch and Congress. But given the importance of the service sector today, and the even greater role it will play in the future--the time to begin this effort is now.

Thank you for your attention. I would be happy to answer any questions you may have.

CHART I

SERVICE SECTOR PROPORTION OF GROSS DOMESTIC PRODUCT* - 1978

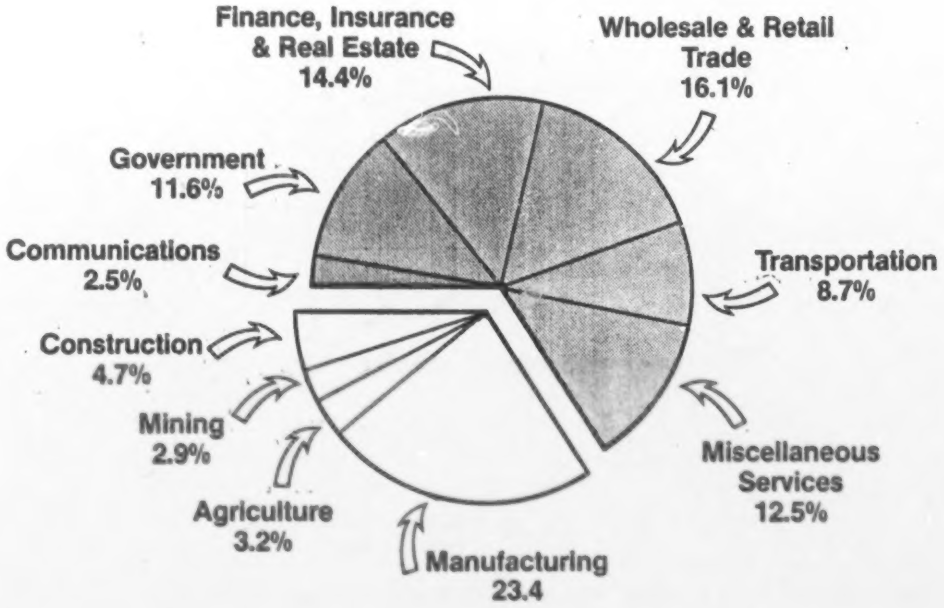


* Excluding Government Services
(a) Data Not Directly Comparable

Source: Committee on Invisible Exports (London)

CHART 2

COMPOSITION OF GROSS NATIONAL PRODUCT
1979

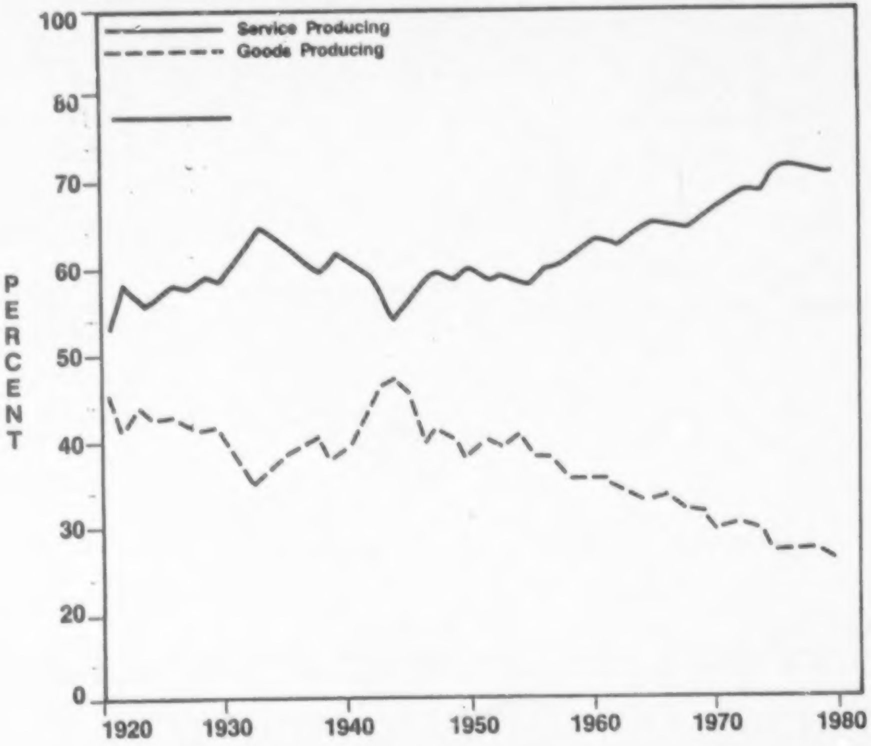


Shaded Areas=Services

Source: U.S. Dept. of Commerce, Bureau of Economic Analysis

CHART 3

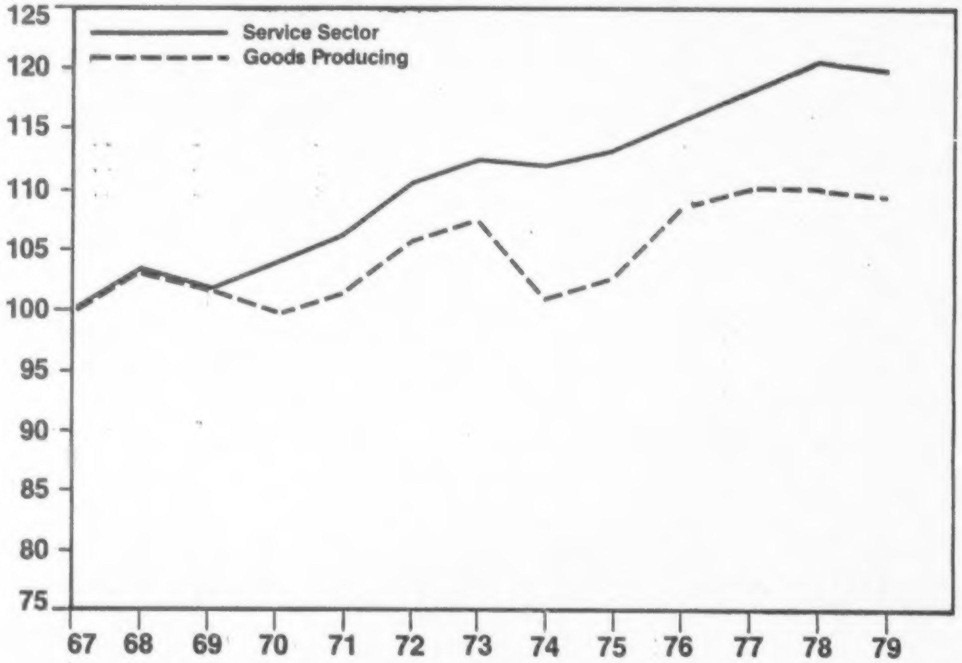
GOODS PRODUCING VERSUS SERVICE PRODUCING EMPLOYMENT AS A PERCENTAGE OF TOTAL NONAGRICULTURAL EMPLOYMENT, 1920—1980



Source: U.S. Dept. of Labor, Bureau of Labor Statistics

CHART 4

SERVICE AND GOODS PRODUCING INDUSTRIES TOTAL FACTOR PRODUCTIVITY
(1967=100)



Source: U.S. Dept of Labor, Bureau of Labor Statistics

CHART 5

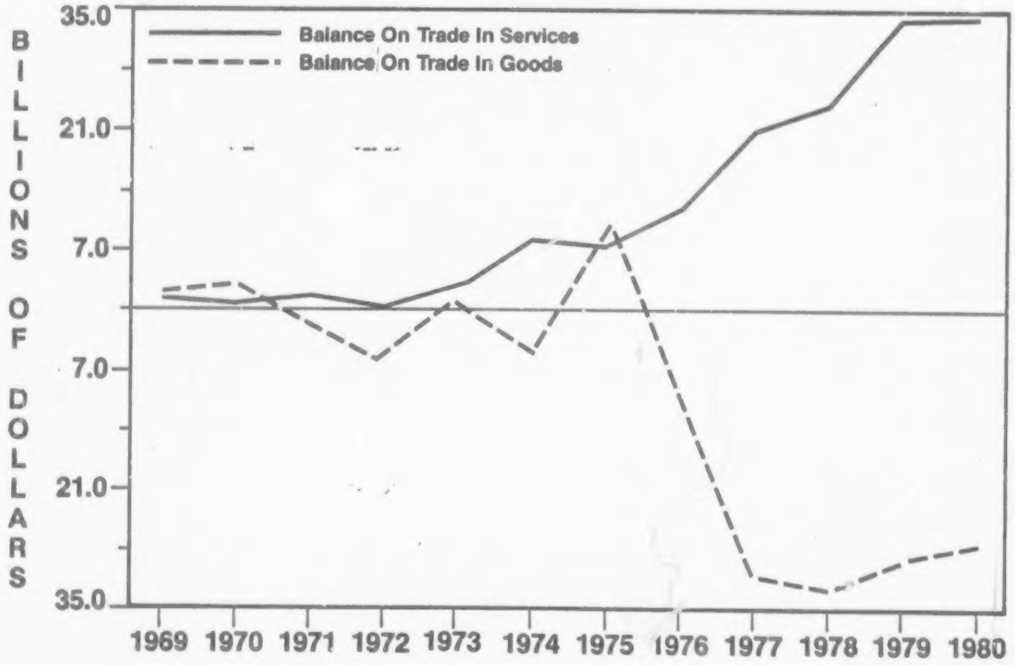
ESTIMATED FOREIGN REVENUES OF THE U.S. SERVICES SECTOR, 1980

SERVICE INDUSTRY	FOREIGN REVENUES (billions dollars)
Accounting	2.35
Advertising	2.05
Banking	9.10
Business/Professional Technical Services	1.07
Construction and Engineering	5.36
Education	1.25
Employment	0.55
Franchising	1.26
Health	0.27
Information	0.60
Insurance	6.00
Leasing	2.35
Lodging	4.60
Motion Pictures	1.14
Tourism	4.15
Transportation	13.93
Subtotal, 16 service insustries	56.05
Miscellaneous financial services, communications, etc.	4.00 (est.)
TOTAL OF U.S. SERVICES SECTOR	$60 billion

SOURCE: THE ECONOMIC CONSULTING SERVICES, INC.

CHART 6

U.S. BALANCE OF PAYMENTS TRADE IN GOODS & SERVICES



Source: U.S. Dept of Commerce, Bureau of Economi : Analysis

THE INTERNATIONAL OPERATIONS OF U.S. SERVICE INDUSTRIES:
CURRENT DATA COLLECTION AND ANALYSIS

Economic Consulting Services Inc.
1320 Nineteenth Street, N.W.
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JUNE 1981

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Preface

This is the final report submitted by Economic Consulting Services Inc. (ECS) in connection with Contract No. 1722-020164 of the U.S. Department of State, entitled The International Operations of U.S. Service Industries: Current Data Collection and Analysis.

This study was carried out under the direction of Stanley Nehmer. Christopher T. Mark was Senior Project Coordinator. Principal Investigators were Bruce Malashevich, Mark Love, Clark Chandler and Diana Hastings, assisted by Marci Dobal, Robin Hill, Clarisse Morgan, Denys Resnick, and Lynn Wino.

Work on this project commenced on October 1, 1980; a preliminary draft report was submitted on January 30, 1981, and a draft final report was submitted on May 6, 1981. Both of the earlier versions of this study were reviewed and discussed in meetings arranged by the State Department between the principal members of the ECS project team and representatives of interested U.S. Government agencies. Following each of these sessions, appropriate changes were made in the text of the report.

In addition to the guidance provided by officials of the U.S. Departments of State and Commerce, the Office of the U.S. Trade Representative, and other U.S. Government agencies, the ECS project team was immeasurably aided by the advice and suggestions offered by more than 60 firms and industry associations in the private sector with which the project team consulted during the course of this study. In addition, the membership of the International Services Industry Committee of the Chamber of Commerce of the United States functioned informally as an *ad hoc* advisory council throughout the duration of the study.

The views expressed in this report are those of the contractor and do not necessarily represent the views of those consulted during its preparation, nor the official views or policy of the United States Government.

Executive Summary

In historical perspective, the United States appears to be evolving into a "service economy," in which the production of physical goods accounts for a steadily declining share of the Gross National Product.

Such a fundamental shift may be an inevitable feature of economic advancement; other industrialized countries appear to be undergoing similar changes. The increasing prominence of service activities in the economy is clearly linked to a country's rising levels of overall prosperity and affluence. In a domestic context, this may generally be regarded as a welcome development.

However, the evolution of a "service economy" necessarily has profound implications for a country's international economic situation. How successfully the United States manages the transition -- especially in comparison with similar adaptations by its major trading partners -- will increasingly depend on maintaining and improving the U.S. competitive position in international services transactions.

The purpose of this study is to examine the current system of international services data collection and to evaluate the data being generated, in order to identify the essential facts and trends which define the commercial interests of the United States in this area. Because the issues and problems involved are relatively novel, the presently available data are in most cases incomplete and in some cases seriously inadequate for the potential needs of policy-makers. The analysis contained in this report is designed to assess the strengths and limitations of existing official and private sources of international services data, in terms of current and potential U.S. commercial-policy requirements.

The study is based on the assumptions that (a) its results should help to focus and support the development of new or modified international economic policies appropriate for the United States as a "service economy," but that (b) a fundamental re-arrangement of official statistical systems is not likely to be realized over the near to medium term.

In order to consolidate the existing basis for policy analysis and future research in the services field, therefore, the study outlines the key technical aspects of all statistical systems that were identified as relevant to the issue. These are described with respect to international services data collection by U.S. Government agencies (Section II); by international organizations (Section III); and by the private sector (Section IV). Also, Appendix A contains a series of explanatory notes to the entries in Figures C, D and E, drawing upon and reflecting the results of all research reported in Sections II through V; the Appendix may thus be used as an overview and technical index of the entire system of international services data collection.

In Section V are 16 service-industry "profiles" which describe (a) the relevant characteristics of the available data, and (b) the nature of the industry's international operations -- in terms of their type, magnitude, importance, location and trends -- along with overall estimates of their size.

Taken together, the estimates for all 16 industries yield an "order of magnitude" for the international commercial stake of the United States in the services sector of about $60 billion in 1980. This figure is at a level which is nearly two-thirds that of U.S. capital-equipment exports, and is roughly equal to total U.S. exports of all food and consumer goods in 1980. It should also be noted that this estimate is nearly double the amount shown by conventional statistics for U.S. exports of services in 1980. As discussed in the report, the difference is largely due to the recording of many service industries' foreign earnings under the heading of investment income in the balance of payments.*

The salient points of the analyses for each of the 16 service industries studied, and the approximate magnitude of their 1980 foreign revenues, are as follows:

- Accounting -- An important "behind-the-scenes" industry in terms of supporting the international operations of all types of U.S. firms, with rapid expansion in foreign activity likely (principally through affiliations of separate partnerships). Currently generating foreign revenues in excess of $2 billion.

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* The specific elements involved in constructing the ECS order of magnitude are outlined and explained in summary form in Table 8 on page 294.

- Advertising -- Extremely competitive internationally, yet frequently of critical importance in international marketing of all types of goods and services. Approximately $2 billion is presently being generated as the U.S. industry's income from foreign operations.

- Banking -- Traditionally regarded as one of the strongest of U.S. industries active internationally, facing stiffening competition from other countries' banks locally as well as in third-country markets. Foreign revenue*, now in excess of $9 billion, is second only to the Transportation industry among the 16 service industries studied.

- Business, Professional and Technical Services -- More than just a residual grouping of service activities, this industry in fact may represent "the leading edge" of the U.S. international competitive position. Roughly $1 billion in foreign-sourced receipts in 1980.

- Construction and Engineering -- A major generator of U.S. foreign business, both in its own right and as a "trail-blazer" for U.S. merchandise exports, the industry faces serious problems in key international markets. Over $5 billion in services provided by the U.S. firms in projects overseas.

- Education -- An important producer of foreign revenue, based on the international prestige of U.S. centers of learning, increasingly augmented by receipts of entrepreneurial firms engaged in producing and distributing sophisticated learning systems for use by business and industry. Approximately $1¼ billion in foreign revenues.

- Employment -- Segments of this industry differ considerably with respect to international business prospects. Temporary-placement agencies and executive search firms constitute a dynamic aspect of the U.S. competitive position in services, generating over one-half billion dollars in foreign revenues.

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* For reasons which are discussed in the report, the estimate for the banking industry is net of overseas offices' interest payments (which, if included, would raise the total order-of-magnitude for the U.S. services sector to nearly $100 billion); estimates for all other service industries (receipts, sales, billings, etc.) essentially concern gross transactions.

- Franchising -- An "industry" comprised of firms employing an exceptionally rewarding marketing technique, with widespread international operations that produce over $1¼ billion in revenues.

- Health -- Like the education industry, the health services industry draws its strength from the international prestige of U.S. institutions, but includes a number of highly-competitive firms providing technical expertise in establishing or maintaining modern health-care delivery systems and their components. About one-quarter billion dollars in foreign revenues are being generated.

- Information -- Encompassing data processing and computer software services, this nascent industry is likely to be central to the productive structures of industrialized countries in the twenty-first century. Extremely competitive and rapidly developing, the U.S. industry already accounts for more than one-half billion dollars in foreign revenues.

- Insurance -- Traditionally a highly prominent U.S. industry in international markets which plays an essential role in supporting the foreign sales of U.S. business and industry in general. The third largest generator of foreign revenues among U.S. service industries, earning roughly $6 billion in 1980.

- Leasing -- Another "industry" built around a marketing concept which in recent years has begun to be employed in all sectors of industrialized economies, from manufacturing through marketing and distribution. Over $2 billion in foreign revenues in 1980, with buoyant growth prospects.

- Lodging -- An industry in which U.S. firms have long been worldwide leaders. The market outlook is highly sensitive to global economic trends, but U.S. establishments' revenues derived from foreigners were in excess of $4.5 billion in 1980.

- Motion Pictures -- An industry in which U.S. firms have played a leading role internationally, and in which foreign sales have accounted for nearly half of the major U.S. studios' billings. Over $1 billion in foreign revenues are generated.

- Tourism -- One of the largest single items in international commerce, supporting more than a quarter-million American jobs. Over $4 billion in tourist travelers' expenditures in the United States were registered in 1980.

- Transportation -- The top ranking U.S. service industry in terms of international receipts, comprised of both airlines and maritime shipping lines. Nearly $14 billion in foreign revenues were earned in 1980.

In Section VI the scope and quality of available data are assessed in general terms. It is shown that current U.S. Government data are fairly extensive in scope, with at least some information being generated on most key variables for the designated service industries. Moreover, to a limited extent some of the "gaps" in the official data series can be bridged with information produced by international organizations and by the private sector.

In more detailed technical terms, however, it is seen in Section VI that important definitional issues must be addressed when the industry-specific data being sought for policy purposes in the services field are compared with balance-of-payments statistics, which are organized in terms of types of economic transactions. It is observed that many of the apparent problems concerning the "quality" of official statistics actually result from expecting the conventional data systems -- such as the balance of payments -- to support new or modified policy purposes which they were never designed to meet.

It must be stressed that this aspect of the study does not debate the approaches economists have traditionally used in analyzing balance-of-payments statistics, nor does it attempt a critique of the official agencies which are responsible for compiling such data. Instead, the point is made that the emerging concerns about U.S. competitiveness in international services transactions may risk "short-circuiting" the traditional statistical system, by forcing data that have been developed in a domestic context into possibly-inappropriate international applications.

The available data on services are also evaluated in Section VI with respect to three broad types of international activity: exports of U.S.-based service firms; overseas sales by service industry affiliates; and "investment-related" service transactions. The assessment in Section VI shows that there are significant shortcomings in the available data with respect to measuring (a) foreign market penetration by U.S. service industries, and (b) service transactions by industries that are known primarily as goods-producers.

Some concluding observations are set out in Section VII with regard to possible directions for future policy development and research concerning international services trade and investment:

-- In light of the experiences of the late 1960s, when official and private-sector attention was being focused on non-tariff barriers despite the absence of a well-established data base, it is likely that it will be some period of time before the international services field can be sufficiently "mapped" so that full-scale negotiations on the subject can be pursued.

-- Although the results of the study suggest it is possible for certain technical modifications to be made in the current system of U.S. Government data collection on services, prevailing budgetary and administrative circumstances apparently will preclude extensive changes in the system for the foreseeable future. Some interim measures that might be useful include organizing auxiliary systems of services data-collection, focusing on appropriate "self-help" efforts on the part of the private sector.

-- In light of the study's findings, it is suggested that an important and promising area for applied economic analysis in the future would concern more detailed identification and measurement of productivity in the services sector, and of the nature and magnitude of the various service industries' "exports."

The study concludes that, notwithstanding the imprecision of the underlying data and the methodological problems involved in its construction, the ECS order-of-magnitude estimate makes it quite clear that the United States already has a surprisingly large stake in the international operations of its service industries. This fact will necessarily be a major factor in shaping U.S. commercial policy for the next two decades and into the twenty-first century.

Table 8

ESTIMATED FOREIGN REVENUES OF THE U.S. SERVICES SECTOR, 1980

Service Industry	Reference[1/]	Foreign Revenues[2/] (billion dollars)
Accounting	A-4 (p. 76)	2.35
Advertising	B-5 (p. 88)	2.05
Banking	C-5 (p. 103)	9.10
Business/Professional/ Technical Services	D-2 (p. 113)	1.07
Construction and Engineering	E-4 (p. 126)	5.36
Education	F-2 (p. 136)	1.27
Employment	G-4 (p. 147)	0.55
Franchising	H-3 (p. 158)	1.26
Health	I-4 (p. 167)	0.27
Information	J-3 (p. 180)	0.60
Insurance	K-3 (p. 194)	6.00
Leasing	L-3 (p. 208)	2.35
Lodging	M-3 (p. 220)	4.60
Motion Pictures	N-5 (p. 231)	1.14
Tourism	O-4 (p. 247)	4.15
Transportation	P-4 (p. 263)	13.93
Subtotal, 16 service industries		56.05

TOTAL U.S. SERVICES SECTOR[3/] .... $60 billion

[1/] Entries refer to table numbers in Section V in which derivation of ECS estimates on each industry's international business operations is explained.

[2/] Quantities being considered as "Foreign Revenues" vary from industry to industry; see respective tables listed under "Reference" for details. The following key points should be noted:

- All estimated quantities are essentially gross transactions (receipts, sales, billings, etc.) except for those of the Banking industry;
- Because of the characteristics of international services performed by the Banking industry (see Table C-5), the estimated "Foreign Revenues" are net of overseas offices' interest payments (which, if they were included here, would raise total order-of-magnitude for U.S. Services Sector to nearly $100 billion);
- For Franchising industry, estimate has been adjusted to avoid double-counting of certain transactions attributed to the Employment and Leasing industries (see Table H-3);
- For Tourism industry, estimate has been adjusted to avoid double-counting of certain transactions attributed to the Education and Lodging industries (see Table O-4);
- For Lodging industry, estimate refers to U.S. establishments' revenue from foreigners; industry's overseas receipts are incorporated in estimate for Franchising (see Table M-3).

[3/] Includes 16 designated service industries plus communications, non-bank financial services, and miscellaneous services (see text, Section I).

Prepared by Economic Consulting Services Inc.

Questions for Joan E. Spero—American Express

1. Ms. Spero, let me play the devil's advocate for a moment. If service export earnings have been expanded at 19 percent annual average for the past decade, twice the rate of the previous decade and faster than non-service export expansion, how can you argue that there is a problem which demands priority attention?

2. On page 5 of your testimony you talk about "invisible barriers to invisible trade" as an apt description of service export problems. But, isn't this a significant part of the problem, in that some of the legislation enacted by our trading partners in the guise of "personal privacy," "national security," or "economic development" may serve that purpose but also serve to restrict or severely handicap U.S. service exports?

Isn't that the most difficult part of the problem of identifying barriers to service exports, the subtle ways in which such exports are restricted?

3. You endorse the Pressler/Inouye Service Industries Development Act. How well would you say the U.S. Government is presently organized to analyze and make policy for the service exporting sector?

4. In your list of suggestions you say that the authority of the President should be clarified under Section 301 of the Trade Act to impose restrictions on the service industries of other countries that discriminate against our service industries. Do you have any specific language or suggestions on that?

5. You also suggest that Federal Regulatory agencies should be compelled to consider the position of U.S. service interests in relevant foreign markets before granting access to our market. Where else, besides banking, would this be effective?

6. You note that service sector problems are not solely American concerns, which is true, but is it not our service industries' strength and comparative advantages which diminish the incentive of our trading partners to reach agreements eliminating barriers?

How can we overcome that built-in disincentive to negotiate with us?

7. Does your company have projections of the probable growth of service industry exports in the 1980s?

Do you think they will grow at the 19 percent annual rate of the 1970s?

8. What types of studies do you think the Administration should undertake so as to better enable us to respond to services trade problems?

Response to Questions From Joan E. Spero—American Express

1. As I illustrated in my testimony, services have recently emerged as a rapidly growing sector in the U.S. economy. However this annual average growth of 19 percent has occured despite the barriers services encounter overseas. Given the softening of the world economy, it is essential that we move to strengthen our valuable assets—services—so that they can further strengthen the U.S. economy. In essence we are "fighting the future war"—actions we take now will prevent more severe problems in the future.

2. The subtlety of the barriers to services is definitely a major problem in seeking to address and dismantle these obstacles. But non-tariff barriers were successfully identified for Tokyo Round negotiations.

3. The current government organization is adequate, if not ideal, to address service sector issues. What we must do is generate more attention and resources to handle service sector concerns within the existing structure.

4. Language is currently being developed to clarify Section 301 of the Trade Act to address service sector needs. I expect that it will be in final form and officially introduced as legislation in the early part of 1982.

5. Banking is only one segment where the U.S. government should consider parity treatment. All other sectors including insurance, engineering, communications, technology, etc., should be included in this discussion.

6. Yes, it is true that it will be difficult to convince our trading partners to enter into negotiations. We must work with our respective counterparts to demonstrate our common interest in free trade.

7. Given the volatility of the world economy, it is difficult to project the future growth of services. However, if we can effectively work to erode obstacles to trade in services, I believe that services can continue to grow at a comparable pace.

8. Much work has been done analyzing trade in goods. Similar studies must be done to examine the theoretical base for trade in services to see whether the same principles apply. Likewise, it is important to study to what extent services fit into existing legal and trade frameworks. For example, we must assess whether services can be incorporated into GATT.

Senator **Heinz**. Ms. Spero, thank you very much.

Mr. McCouch?

STATEMENT OF DONALD G. McCOUCH, PRESIDENT, BANKERS ASSOCIATION FOR FOREIGN TRADE, AND SENIOR VICE PRESIDENT AND DEPUTY GENERAL MANAGER, MANUFACTURERS HANOVER, ACCOMPANIED BY JAMES S. CASSIN, EXECUTIVE VICE PRESIDENT, FIRST NATIONAL BANK OF CHICAGO

Mr. McCouch. My name is Donald A. McCouch. I am president of the Bankers' Association for Foreign Trade (BAFT). I am also senior vice president and deputy general manager of Manufacturers Hanover Trust Co., of New York. I am joined today by James Cassin, executive vice president of the First National Bank of Chicago, a BAFT director, who heads the BAFT committee dealing with the treatment of U.S. banks abroad. I am also joined by BAFT's counsel, Thomas L. Farmer and Gary M. Welsh, of the Washington law firm of Prather, Seeger, Doolittle & Farmer.

I would like to thank you, Mr. Chairman, for scheduling these hearings on barriers to U.S. trade in services, and for giving us the opportunity to describe the obstacles which U.S. banks often face abroad. For too long there has been a perception that U.S. banks face relatively few barriers to their operations abroad. As is too often the case, this conventional wisdom is not borne out by the facts. United States bankers abroad encounter a host of discriminatory restrictions which often deny them entry to foreign markets or severely restrict their operations once they are there.

With greater attention now being paid to U.S. service industries it is thus entirely appropriate that greater attention be paid by the U.S. Government to opening up opportunities for U.S. banks overseas. Our prepared statement, Mr. Chairman, contains a great deal of statistical information on the international operations of U.S. banks and the U.S. operations of foreign banks. We hope this information will prove useful to the subcommittee.

Rather than review it here, I would like to proceed to the real focus of our testimony, the types of restrictions and prohibitions facing U.S. banks abroad, a suggested trade policy regarding U.S. barriers to banking, and suggested procedures to help eliminate those barriers.

Senator Heinz. Without objection, we will place your entire statement in the record.

Mr. McCouch. What kinds of barriers and restrictions face U.S. banks abroad? In leading into the subject, I should say that in our judgment the intense competition that now exists in international banking and the growing foreign bank share of our own U.S. market underscore the importance to the United States of reducing barriers to our banks abroad. United States banks are well aware of the differences in the world's banking systems. We have no objection to laws that are uniformly applied to all banking institutions in a particular foreign country. We seek to be good citizens in whatever country we're doing business. What we do object to are laws and practices in foreign countries that unfairly discriminate against foreign banks, especially against U.S. banks.

The national treatment study mandated by the International Banking Act of 1978, (IBA) and the special trade representative's preliminary survey of foreign bank restrictions in foreign countries both provide a fairly comprehensive catalog of the types of discriminatory restrictions which foreign banks, generally, and hence U.S. banks, specifically, face in their overseas operations.

PROHIBITIONS AND RESTRICTIONS

The first and most basic are prohibitions and restrictions on the establishment of banking operations. They include complete prohibitions on the establishment of any banking presence by foreign banks, prohibitions on the establishment of any type of banking operation by a foreign bank other than a representative office or correspondent relationship with a local bank, prohibitions on purchase by foreign banks of any interest in a local bank, limitations on the level of foreign equity participation in local banks or limits on the degree of foreign control of local banks, limitations on the formation of foreign banking subsidiaries, limitations on the level of foreign equity participation in consortium banks (joint ventures) or so-called near-bank enterprises, prohibitions on the establishment of branches of foreign banks, and excessive local capital requirements for branches of foreign banks.

Sometimes such restrictions or prohibitions are matters of administrative policy or practice rather than statute. For example, in some countries official policy is such that no foreign bank would ever be given permission to acquire a local bank, albeit this is not prohibited by law.

Second, U.S. banks often face discriminatory operating restrictions that can negate or reduce the opportunities presented by what appear to be open entry policies. It is not enough to achieve entry in a foreign market, one must also be given the opportunity to operate in a profitable and competitive manner.

Again, these restrictions can be matters of administrative practice and can be relatively subtle in their application to foreign bank operations. Some types of operating restrictions impose higher operating costs on the United States and other foreign banks and thus put them at a competitive disadvantage with local banks in providing services.

Other types of operating restrictions deny U.S. banks competitive opportunities available to their local counterparts in foreign markets; that is to say, U.S. banks may be prohibited from engaging in certain services that local banks can offer, or U.S. banks may find that while they can offer services provided by local banks, their offering of such services is subject to absolute limits or other special requirements that do not apply to local banks.

Here is a basic laundry list of the most common types of discriminatory operating restrictions encountered by U.S. banks abroad:

Reserve requirements applied in ways that affect foreign banks more heavily than domestic banks; liquidity or capital asset ratios, whose impact is more severe on foreign banks than on local banks; taxation that weighs more heavily on foreign banks than on their domestic counterparts; prohibitions against foreign banks undertaking foreign exchange transactions that may be undertaken by local banks; restrictions on the repatriation of funds or profits by foreign banks; restricted access to rediscount facilities available to local banks; restricted access to subsidized funds for export financing available to local banks; overall capitalization limits that only apply to foreign bank operations; credit or lending ceilings applied unequally against foreign banks; specified loan portfolio structures applied unequally against foreign banks; swap limits or otherwise restricted access to local currency funding for foreign banks; ceilings or prohibitions on foreign bank loans in domestic or foreign currencies; restricted foreign bank access to local government deposits; restrictions on the amount or types of securities or other financial assets that can be acquired by foreign banks; restrictions on the ability of certain depositors, such as mutual funds or insurance companies, to deposit funds in foreign banks; prohibitions or limitations on foreign banks' acceptance of retail or certain other kinds of public deposits; prohibitions or policies which limit the types of domestic or international banking services which foreign banks can offer; prohibitions or limitations on branching or other forms of expansion by foreign banks; and more stringent or restrictive enforcement of apparently nondiscriminatory regulations on foreign bank operations.

Third, there are restrictions that concern Government regulations often aimed at nonbanking objectives which nevertheless hamper U.S. and other foreign banks in competing with local banks. Among these more general types of restrictions are certain foreign exchange controls, certain regulations concerning the transmission of data across national boundaries, certain immigration controls and other restrictions regarding the use of foreign personnel, certain professional licensing requirements and certain rules governing the publication of financial statements.

This is a long list, but I wanted to read it all, because I think it gives a clear picture that U.S. banks face a multitude of restrictions abroad that can greatly affect the ability of U.S. banks to enter and compete in foreign markets. The picture is an ever-changing one. Improvements in some countries are matched by new impediments in others. Overall, it is hard to say whether the situation is getting better or worse. Clearly, the situation will remain serious for the foreseeable future. Equally clearly, elimination or reduction of barriers will strengthen the competitive position of U.S. banks in world markets and will better enable them to serve both large and small U.S. business customers and will contribute to a strong U.S. trade position.

I would now like to propose a policy regarding trade barriers in banking. Rapid growth of foreign bank operations in the United States during the 1970's led, of course, to the enactment of the IBA which established national treatment or nondiscrimination as the guiding U.S. policy toward foreign bank operations in the United States While some have advocated that the regulation of foreign banks in the United States should follow a reciprocity principle, permitting or denying foreign banks from doing in the United States what U.S. banks are permitted or denied abroad, this principle was rejected for two basic reasons.

First, given the great diversity of bank systems in the world, it would have been unworkable. Second, such a policy in some cases would have resulted in foreign banks engaging in U.S. activities denied to U.S. banks. For example, the underwriting and distribution of corporate securities. In the IBA the United States took a pragmatic and sensible approach to national treatment that not only eliminated most of the competitive concerns of U.S. banks but also eliminated any possibility for retaliation against U.S. bank interests approach. While the playing field was not leveled, most major holes were filled in to provide a rough parity of treatment.

In considering what should be the proper thrust of U.S. policy toward removing trade restrictions for U.S. banks abroad, we believe the IBA's pragmatic approach to national treatment has much to recommend it. There is great diversity among the world's banking systems, and thus a rigid approach to national treatment is likely to prove unworkable in many countries. A highly legalistic approach to national treatment can also disserve U.S. banks which may find legal opportunities greatly circumscribed by informal policies or administrative practices or which at times may need special rules that take into account the more specialized nature of U.S. bank operations in a particular country.

In essence, in securing national treatment for U.S. banks abroad, U.S. policymakers will, as in any other negotiation, have to make judgments as to what is best for U.S. banks and what is attainable within the confines of sometimes very different banking systems. The goal should be to obtain effective national treatment within a country which allows U.S. banks to engage in services and activities they need or want to perform on terms that are basically equivalent to those applied to local banks.

While we believe that achievement of effective national treatment is the most appropriate policy for the United States to pursue on the national level, we would note that State reciprocity laws have often been extremely helpful in opening up markets for U.S. banks abroad.

The attractiveness of the U.S. market to foreign banks can thus serve as important leverage in negotiations designed to gain entry for U.S. banks in foreign markets. Since we believe that national treatment should be a two-way street, we thus believe that it would be entirely appropriate for U.S. authorities to consider a foreign country's treatment of U.S. banks as at least one ingredient in their decisions regarding foreign bank operations in this country.

Now what should the working approach be to reducing trade barriers to U.S. banks abroad? In other words, by what means should the United States reduce the trade barriers?

NEGOTIATIONS WITH HOST GOVERNMENT

It might first be useful to relate how U.S. banks have sought to deal with the types of restrictions or barriers discussed. The preferred approach is to try to work with the host government on a largely informal basis to reduce or eliminate those barriers or restrictions which are most severely impacting entry or operations. In support of such consultative efforts or when it has been clear that such efforts were likely to be unsuccessful on their own, U.S. banks have sought assistance from the U.S. Government.

It is difficult for us to generalize about the results of these efforts. Over the years, banks have received assistance from the Treasury Department, which has generally taken the lead in this area. The U.S. Trade Representative has assisted in identifying issues and initiating studies. The Federal Reserve and State Department have also assisted in appropriate circumstances. These efforts have been helpful but have been modest in scope and could well be, and we believe should be, expanded in support of a cohesive national program designed to promote national treatment.

In its work program on trade in services first announced last April by the Cabinet level Trade Policy Committee, the administration has set forth a five-point plan which provides an excellent approach to this general area. I will briefly mention each of these five points.

First, we strongly support bilateral efforts to reduce discrimination in banking services and believe that especially in the short term, bilateral efforts hold the best chance for successful results in the banking sphere. Bilateral negotiations will always be extremely important in banking services, given the diversity of banking systems in the world and the effects of sometimes subtle but nonetheless crucial administrative practices on banking operations abroad.

Second, with respect to export disincentives in the services area, BAFT has been a strong supporter of the Export Trading Company Act of 1981 and of legislation increasing the bankers acceptance limits of U.S. member banks, proposals designed to modify internal U.S. policies which burden our ability to compete internationally. We would especially like to commend the chairman of this subcommittee for his outstanding leadership on these issues.

Third, as concerns possible multilateral negotiations, we note that in its statement of objectives for trade negotiations, the administration indicated that at present no coherent international framework exists for resolving trade problems in services. We thus support the administration's efforts to attract a greater degree of attention to the services sector in the OECD, the GATT, the European Community, and other international fora.

Fourth, with reference to reciprocity in the U.S. services area, the IBA established national treatment, not reciprocity, as the guiding U.S. principle toward foreign bank operations in this country. As previously discussed, however, we believe that national treatment should be a two-way street. Thus it might be useful to have a foreign country's treatment of U.S. banks constitute one factor to be considered by U.S. regulatory authorities in their decisions on foreign bank operations in this country.

Lastly, we agree that better official data on service industries is criticially needed. However given the already substantial reporting burdens imposed on U.S. banks, we would urge that the administration work with the banking agencies and the banking industry to avoid unnecessary or costly new reporting obligations.

TRANSPORT OF DATA FLOWS

Finally, a word about the special problem of transborder data flows. Mr. Fishman will deal with this in its broader aspects, but we would like to take this opportunity to briefly highlight the special concerns of our members in this area.

The international banks of today depend upon the free flow of information throughout the world to operate automated networks to transfer money and information to customers, branches, subsidiaries, other banks, and government agencies. International banking and foreign trade rely upon telecommunications and data processing media which are increasingly subject to regulations and restrictions that may pose a threat to the free flow of information and that may adversely affect the quality, cost, and efficiency of international banking services. Thus in addition to recommending pursuit of a policy of effective national treatment for U.S. bank operations overseas, BAFT also believes it is crucial that U.S. policy be directed toward maintaining the free flow of information necessary to conduct effective international operations.

Both of these policies must be pursued because work done to remove a barrier in the banking sector, for example, could be quickly offset by new restrictions on information flows.

Mr. Chairman, thank you again for giving us the opportunity to testify on this important subject. If I or my colleagues can answer any further questions or supply further information, we will be pleased to do so.

[The complete statement and answers to additional written questions follow:]

STATEMENT OF

DONALD G. McCOUCH

PRESIDENT

BANKERS' ASSOCIATION FOR FOREIGN TRADE

AND

SENIOR VICE PRESIDENT AND DEPUTY GENERAL MANAGER - INTERNATIONAL

MANUFACTURERS HANOVER TRUST COMPANY

My name is Donald G. McCouch and I am President of the Bankers' Association for Foreign Trade (BAFT). I am also Senior Vice President and Deputy General Manager - International of Manufacturers Hanover Trust Company of New York. I am accompanied by James A. Cassin, a BAFT Director who is also Chairman of the Association's U.S. Banks Abroad Committee and an Executive Vice President of The First National Bank of Chicago. We are joined by the Association's counsel, Thomas L. Farmer and Gary M. Welsh of the Washington law firm of Prather Seeger Doolittle & Farmer.

BAFT was founded in 1921 by a group of banks whose purpose was to expand their knowledge of international trade and to develop sound banking services and procedures in support of trade. Today, BAFT's voting membership of 151 U.S. banks includes virtually all of those having significant international operations. The Association also includes as non-voting members 94 foreign banks maintaining offices in the United States.

BAFT would first like to thank you Mr. Chairman for scheduling these hearings on barriers to U.S. trade in services, and for giving us the opportunity to describe the obstacles which U.S. banks often face abroad. For too long, there has been a perception that U.S. banks face relatively few barriers to their operations abroad. As is often the case, this conventional wisdom is not borne out by the facts. On a daily basis, U.S. bankers abroad encounter a host of discriminatory restrictions which often deny them entry to foreign markets or severely restrict their operations once they are there. With greater attention now being paid to U.S. service industries, it is thus entirely appropriate that greater attention be paid by the U.S. Government to opening up opportunities for U.S. banks overseas.

The importance of service industries to our economy and international trade position is self-evident. More than half of U.S. GNP is now represented by the services sector. In a recent study done for the Departments of State and Commerce and the Office of United States Trade Representative, Economic Consulting Services, Inc. of Washington estimated that total U.S. service sector exports were about $60 billion in 1980. Bilateral and multilateral negotiations to reduce barriers to U.S. service industries will thus be a crucial issue for the U.S. during the 1980s and beyond. Accordingly, it is important that Congress play a continuous, active role in the development of U.S. policy in this area.

In our statement this morning, we would like to focus the Subcommittee's attention on the types of barriers which U.S. banks have encountered abroad. Before doing so, however, it is important to review briefly a number of salient statistics concerning U.S. banks' overseas operations.

AN OVERVIEW OF U.S. BANKS' INTERNATIONAL OPERATIONS

As indicated in the Treasury Department's "Report to Congress on Foreign Government Treatment of U.S. Commercial Banking Organizations," (the "National Treatment Study"), U.S. banking organizations operate abroad through branches, subsidiaries and affiliates. Branches are the most important form of U.S. banking presence abroad, accounting for over three-fourths of all foreign banking assets. Because some countries prohibit the establishment of foreign bank branches and subsidiaires, U.S. banks have had to enter some foreign markets through minority investments in local banks or through the formation of new institutions on a joint venture basis. In countries prohibiting any form of a direct banking presence, U.S. banks have had to enter through nonbanking subsidiaries or affiliates that offer financial services closely related to banking, e.g. commercial finance companies.

Branches are preferred by most U.S. banks because they are more flexible and less costly to operate, and allow banks to exercise direct control. As of June 30, 1981, 157 U.S. member banks were operating 775 branches in 77 foreign countries.[1/] Table A provides a country-by-

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[1/] Source: Federal Reserve Board.

country breakdown of U.S. bank foreign branches. As can be seen from this Table, foreign operations of U.S. banking organizations have been concentrated in Western Europe, Japan, and the major offshore banking centers.

Assets at foreign branches of member banks, including assets at branches in overseas areas of the U.S., were estimated at $343 billion as of June 30, 1981, a 7 percent increase since year-end 1980. Table B compares the number and total assets of foreign branches of member banks and their Edge Act and Agreement Corporation subsidiaries for the years 1971-1980. It can be seen from this Table that from year-end 1971 to June 30, 1981, there has been a sixfold increase in the amount of foreign branch assets.

In its recent study done for the Departments of State and Commerce and Office of United States Trade Representative, Economic Consulting Services, Inc. estimated that foreign revenues from the international business operations of the U.S. banking industry were $9.1 billion (on a net basis), making banking the second largest U.S. service sector in terms of revenue. See Table C which is taken from the Economic Consulting Services, Inc. Study (the "ECS Study"). The ECS Study noted that non-interest income from international banking has recently increased at a higher rate than interest income. This confirms the view of many U.S. banks with international operations that fees from non-asset based services will become an increasingly important source of revenues and competitive advantage in the years ahead.

Notwithstanding a dramatic growth in foreign assets and profits of U.S. banks, the ECS Study noted that the U.S. market share of all international banking, measured by the world supply of deposits held by major U.S. institutions, has been declining continuously since 1965. While we question the use of total deposits as a true "market share" measure in international banking, it is nonetheless clear that U.S. banks have been facing increasingly stiff competition in providing international banking services both at home and abroad. Two sets of statistics best typify this increased competition.

First, in 1965, U.S. banks had 6 of the world's ten largest banks (ranked by deposits), 16 of the world's fifty largest banks, and 29 of the world's one hundred largest banks. By 1980, U.S. banks had 2 of the world's ten largest banks, 5 of the world's fifty largest banks, and only 13 of the world's one hundred largest banks.

Second, as of December 1973, total assets of foreign banks in the U.S. were $32.3 billion; as of March 1981, total assets of foreign banks in the U.S. were

$205.4 billion, an increase of approximately 635 percent in less than eight years.[1/] Over the same period, foreign banks increased their market share of U.S. banking assets by over 300 percent, from a 3.8 percent market share in 1973 to a 12.3 percent market share in March 1981. This market share is larger in the wholesale banking market where foreign banks have almost 19 percent of total commercial loans in the U.S.; in New York, foreign banks have over 40 percent of the commercial loan market.

TYPES OF PROHIBITIONS AND RESTRICTIONS FACING U.S. BANKS ABROAD

This growing competition in international banking underscores the importance to the U.S. of reducing barriers to our banks abroad. U.S. banks are well aware of the differences in the world's banking systems and we have no objection to laws that are uniformly applied to all banking institutions in a particular foreign country. We seek to be good citizens in whatever country we are doing business in. What we do object to are laws or practices in foreign countries that unfairly discriminate against foreign banks and thus against U.S. banks abroad.

1/ Source: Federal Reserve Board Data Bank. See Table D for a historical perspective on foreign bank growth.

The National Treatment Study mandated by the International Banking Act of 1978 (IBA) and the Special Trade Representative's preliminary survey of foreign bank restrictions in foreign countries both provide a fairly comprehensive catalogue of the types of discriminatory restrictions U.S. banks face in their overseas operations.

First, and most basic, are prohibitions and restrictions on the establishment of banking operations. In order of importance they are

-- complete prohibitions on the establishment of any banking presence by foreign banks;

-- prohibitions on the establishment of any type of banking operation by a foreign bank other than a representative office or correspondent relationship with a local bank;

-- prohibitions on the purchase by a foreign bank of any equity interest in a local bank;

-- limitations on the level of foreign equity participation in local banks or limits on the degree of foreign control of local banks;

-- limitations on the level of foreign equity participation in consortium banks (joint ventures) or so-called near-bank enterprises;

-- prohibitions on the establishment of branches (but not subsidiaries) of foreign banks; and

-- excessive local capital requirements for branches of foreign banks.

Prohibitions and restrictions on establishment thus run the gamut from absolute prohibitions to restrictions on forms of operation. Sometimes, these types of restrictions or prohibitions are matters of administrative policy or practice rather than statutory law, e.g. official policy is such that no foreign bank would ever be given permission to acquire a local bank. The countries that have these types of restrictions vary greatly in both size and stage of economic development. However, the most absolute prohibitions tend to be in countries with nationalized banking systems.

Second, in addition to establishment restrictions, U.S. banks often face discriminatory operating restrictions that can negate or reduce opportunities presented by what appear to be open entry policies. It is not enough to get in a foreign country: one must also be given the opportunity to operate in a profitable and competitive manner in that country. Again, these restrictions can be matters of administrative practice and can be relatively subtle in their application to foreign bank operations.

Some types of operating restrictions impose higher operating costs on U.S. and other foreign banks and thus put them at a competitive disadvantage with local banks in providing services. These types of restrictions have been described as "tax-like" in character because they have cost effects that are equivalent to the imposition of a discriminatory tax. Other types of operating restrictions deny U.S. and other foreign banks competitive opportunities available to their local counterparts in foreign markets. For example, in some cases, U.S. and other foreign banks are prohibited from engaging in certain types of services or activities that local banks can offer. In other cases, U.S. and other foreign banks find that while they can offer services provided by local banks, their offering of such services is subject to absolute limits or other special requirements that do not apply to local banks.

Following is a basic laundry list of the most common types of discriminatory operating restrictions encountered by U.S. banks abroad:

-- Reserve requirements applied in ways that affect foreign banks more heavily than domestic banks;

-- Liquidity or capital/assets ratios whose impact is more severe on foreign banks than on local banks;

-- Taxation that weighs more heavily on foreign banks than on their domestic counterparts;

-- Prohibitions against foreign banks undertaking exchange transactions that may be undertaken by local banks;

-- Restrictions on the repatriation of funds or profits by foreign banks;

-- Restricted access to rediscount facilities available to local banks;

-- Restricted access to subsidized funds for export financing freely available to local banks;

-- Overall capitalization limits that only apply to foreign bank operations;

-- Credit or lending ceilings applied unequally against foreign banks;

-- Specified loan portfolio structures applied unequally against foreign banks;

-- Swap limits, or otherwise restricted access to local currency funding for foreign banks;

-- Ceilings or prohibitions on foreign bank loans in domestic or foreign currencies;

-- Restricted foreign bank access to local government deposits;

-- Restrictions on the amount or types of securities or other financial assets that can be acquired by foreign banks;

-- Restrictions on the ability of certain depositors, such as mutual funds or insurance companies, to deposit funds in foreign banks;

-- Prohibitions or limitations on foreign banks' acceptance of retail or certain other kinds of public deposits;

-- Prohibitions or policies which limit the types of domestic or international banking services which foreign banks can offer;

-- Prohibitions or limitations on branching or other forms of expansion by foreign banks; and

-- More stringent or restrictive enforcement of apparently non-discriminatory regulations on foreign bank operations.

Third, there are restrictions that concern government regulations, often aimed at nonbanking objectives, which hamper U.S. and other foreign banks in competing with local banks. Among these more general types of restrictions are

- -- Certain foreign exchange controls;
- -- Certain regulations concerning the transmission of data across national boundaries;
- -- Certain immigration controls and other restrictions regarding the use of foreign personnel;
- -- Certain professional licensing requirements; and
- -- Certain rules governing the publication of financial statements.

From the above, it is clear that U.S. banks face a multitude of restrictions abroad that can greatly affect their ability to enter and compete in foreign markets. Elimination or reduction of these barriers will strengthen the competitive position of U.S. banks in world markets, will better enable them to serve both large and small U.S. business customers, and will contribute to a strong U.S. trade position in world markets.

A SUGGESTED POLICY APPROACH TO TRADE BARRIERS IN BANKING

The rapid growth of foreign bank operations in the U.S. during the 1970s led, of course, to the enactment of the IBA which established national treatment or nondiscrimination as the guiding U.S. policy toward foreign bank operations in this country. While some had advocated that regulation of foreign banks in the U.S. should follow a reciprocity principle, permitting or denying foreign banks from doing in the U.S. what U.S. banks are permitted or denied abroad, this principle was rejected for two basic reasons. First, given the great diversity of banking systems in the world, it would have been unworkable. Second, such a policy, in some cases, would have resulted in foreign banks engaging in U.S. activities denied to U.S. banks, for example, the underwriting and distribution of corporate securities.

The IBA's approach to national treatment, in the context of specific regulatory issues, was highly pragmatic. For example, though not mandatory for all U.S. banks at the time, the IBA subjected foreign bank branches and agencies to Federal Reserve reserve requirements. The Congress determined that this was effective national treatment because virtually all large U.S. banks were subject to such requirements. The Congress, of course, also determined that it was in the national interest to extend the Federal Reserve's control over this growing sector of the banking system for monetary policy purposes. On the other hand, Congress did not require all foreign bank branches and agencies to be subject to FDIC insurance, even though almost every U.S. bank is subject to these requirements. Only foreign bank branches accepting retail deposits were required to obtain deposit insurance. Here, Congress found less compelling arguments for coverage, since foreign bank branches and agencies were principally engaged in wholesale operations. Moreover, FDIC concerns over the difficulty of insuring branches led to a more limited national treatment solution.

While other examples could be cited from the IBA, the important point is that the U.S. took a pragmatic and sensible approach to national treatment that not only met most of the competitive concerns of U.S. banks but also eliminated any possible cries for retaliation against larger U.S. bank interests abroad. While the playing field was not leveled, most of the major holes were at least filled in to provide a rough parity of treatment.

In considering what should be the proper thrust of U.S. policy toward removing trade barriers to U.S. banks abroad, we believe the IBA's pragmatic approach to national treatment has much to recommend it. There is great diversity among the world's banking systems and thus a rigid approach to national treatment is likely to prove unworkable in many countries, especially those developing countries that are in the midst of trying to establish their own local banking systems. A highly legalistic approach to national treatment can also disserve U.S. banks which may find legal opportunities greatly circumscribed by informal policies or administrative practices, or which, at times, may need special rules that take into account the more specialized nature of U.S. bank operations in a particular country.

In essence, in securing national treatment for U.S. banks abroad, U.S. policy-makers will, as in any other negotiation, have to make judgments as to what is most important for U.S. banks and what is obtainable within the confines of sometimes very different banking systems. The goal should be to obtain "effective" national treatment within a country which allows U.S. banks to engage in the services and activities they need or want to perform on terms that are basically equivalent to those applied to local banks.

While we believe that achievement of effective national treatment is the most appropriate policy for the U.S. to pursue on a national level, we would note that State reciprocity laws have often been extremely helpful in opening up markets for U.S. banks abroad. The attractiveness of the U.S. market to foreign banks can thus serve as important leverage in negotiations designed to open up markets abroad. Since we believe that national treatment should be a two-way and not a one-way street, we believe that it would be entirely appropriate for U.S. authorities to consider a foreign country's treatment of U.S. banks in their decisions regarding foreign bank operations in this country. While national treatment considerations should be a factor in such decisions on foreign bank operations, such considerations should not serve as an absolute precondition to entry or approval. As now pertains, U.S. authorities should have the discretion to weigh and consider a number of other public interest factors in their decisions on foreign bank operations.

A SUGGESTED WORKING APPROACH TO REDUCING TRADE BARRIERS TO U.S. BANKS ABROAD.

The final and most important question is, of course, how and by what means should the U.S. reduce the trade barriers we have mentioned.

It might first be useful to relate how U.S. banks have sought to deal with the types of restrictions or barriers discussed in a particular foreign country. The preferred approach is to try to work with the host government on a largely informal basis to reduce or eliminate those barriers or restrictions which are most severely impacting entry or operations. This consultative approach may be made by a single bank, a group of banks or through a local association of foreign banks in that country. Such an approach can be most useful in dealing with administrative practices or policies that, at times, may be having largely unintended effects on foreign bank operations.

In support of such consultative efforts, or when it has been clear that such efforts were likely to be unsuccessful on their own, U.S. banks have sought assistance from the U.S. Government. It is difficult for us to generalize about the results of these efforts, but, over the years, banks have received assistance from the Treasury Department, which has generally taken the lead in this area. The U.S. Trade Representative has assisted in identifying issues and initiating studies. The Federal Reserve and State Department have also assisted in appropriate circumstances. These efforts have been helpful but have been modest in scope and could well be expanded in support of a cohesive national program designed to promote national treatment.

Before discussing the Administration's Work Program on Trade in Services, let me emphasize that it is not for us to suggest where in our Government a lead or principal role should be assigned in the services area. Some issues, such as local capital/asset ratios or reserve requirements, may be uniquely "banking" issues: other issues, such as restrictions on transborder data flows, which can have a major impact on U.S. banking operations abroad, may affect a number of U.S. service industries. Our main concern is that important banking issues not be neglected in any negotiations.

In its Work Program on Trade in Services, first announced last April by the Cabinet-Level Trade Policy Committee, the Administration has set forth a five-point plan calling for:

-- full use of existing bilateral arrangements with other governments to resolve current trade problems brought to the government's attention by the private sector;

-- inclusion of services in the review of export disincentives;

-- domestic and international preparations for future multilateral negotiations on services;

-- review of domestic legislative provisions relating to the achievement of reciprocity for U.S. service industries; and

-- review of the adequacy of U.S. statistics on trade in services.

On the first point, we strongly support bilateral efforts to reduce discrimination in banking services and believe that, especially in the short term, such an approach holds the best chance for successful results in the banking sphere. Bilateral negotiations will always be extremely important in banking services given the diversity of banking systems in the world and the effects of sometimes subtle but nonetheless crucial administrative practices on banking operations abroad.

With respect to the second point, BAFT has been a strong supporter of the Export Trading Company Act of 1981, and of legislation increasing the bankers' acceptance limits of U.S. member banks, proposals designed to modify internal U.S. policies that burden our ability to compete internationally. We would especially like to commend the Chairman of this Subcommittee for his outstanding leadership on these issues. We will continue to work with the Administration and Congress to identify other areas where the international competitiveness of U.S. banks is being unnecessarily burdened by domestic policies.

Concerning the third point, we note that in its Statement of Objectives for Trade Negotiations in Services (for use in OECD discussions), the Administration indicated that, at present, no coherent international framework exists for resolving trade problems in services. We thus support the Administration's efforts to attract a greater degree of attention to the services sector in the OECD, GATT, the European Community and other international fora. We are encouraged by the fact that many international organizations have begun moving ahead to focus more attention on the services area and that a number of studies are underway. At a Ministerial Meeting of the OECD Council last June, member governments agreed to move beyond data-gathering on services and to "examine ways and means for reducing or eliminating the identified problems and to improve international cooperation." Over the long term, it is possible that multilateral fora may be able to play an important role in identifying barriers to banking and other U.S. service industries in foreign countries and in providing a mechanism for their reduction or removal.

With reference to point four of the Administration's program, the IBA established national treatment, not reciprocity, as the guiding U.S. principle toward foreign bank operations in this country. As previously discussed, however, we believe that national treatment should be a two-way street and thus it might be useful to have a foreign country's treatment of U.S. banks constitute one factor to be considered by U.S. regulatory authorities in their decisions on foreign bank operations in this country.

Lastly, we agree that better official data on service industries is needed. In order to develop effective policies, the Government must have a precise picture of the services sector and must have accurate mechanisms for measurement of the balance of payments and other positive effects of service industries. Given the already substantial reporting burdens imposed on U.S. banks, however, we would urge the Administration to work with the banking agencies and banking industry to avoid unnecessary or costly new reporting obligations.

THE SPECIAL PROBLEM OF TRANSBORDER DATA FLOWS

While we understand that another witness this morning will be dealing with the broader subject of transborder data flows, we would like to take this opportunity to briefly highlight the special concerns of our members in this area. The international banks of today depend on the free flow of information throughout the world to operate automated networks transferring money and information to customers, branches, subsidiaries, other banks and government agencies. International banking and foreign trade rely upon telecommunications and data processing media which are increasingly subject to regulations and restrictions that may pose a threat to the free flow of information and that may adversely affect the quality, efficiency and cost of international banking and financial services.

Thus, in addition to recommending pursuit of a policy of effective national treatment for U.S. bank operations overseas, BAFT also believes it is crucial that U.S. policy be directed toward maintaining the free flow of information necessary to conduct international banking operations. Both of these policies must be pursued because work done to remove a barrier in the banking sector, for example, could be quickly undone by a new restriction on information flows. Because the transborder data flows issue affects a number of service industries, it is thus deserving of high priority in our international negotiations on trade in services.

CONCLUSION

In conclusion, we are gratified to see the great degree of attention which the services area is beginning to receive both within the Administration and the Congress. The U.S. cannot afford to be complacent in this area, because it is simply too important to our future economic growth.

Mr. Chairman, thank you again for giving us the opportunity to testify on this important subject. If I or my colleagues can answer any questions or supply further information, we would be pleased to do so.

TABLE A.—BRANCHES OF MEMBER BANKS IN FOREIGN COUNTRIES AS OF JUNE 30, 1981 [1]

Country name	Total	Country name	Total
Argentina	53	Korea, Democratic Peoples Republic	2
Austria	1	Korea, Republic of	13
Bahamas, The	75	Lebanon	6
Bahrain	7	Liberia	2
Barbados	4	Luxembourg	4
Belgium	9	Malaysia	6
Bolivia	4	Martinique	1
Brazil	20	Mauritius	1
British Virgin Islands	2	Mexico	5
Brunei	3	Monaco	1
Cayman Islands	83	Nambia	1
Chile	6	Netherlands	6
China	1	Netherlands Antilles	2
China (Taiwan)	9	Nicaragua	2
Denmark	3	Oman	2
Dominican Republic	17	Pakistan	6
Ecuador	14	Panama	33
Egypt	6	Paraguay	9
El Salvador	2	Peru	3
France	14	Philippines	13
Gabon	1	Qatar	1
German Democratic Republic	4	Romania	1
Germany, Federal Republic of	23	Senegal	1
Greece	17	Seychelles	1
Guadeloupe	1	Singapore	24
Guatemala	4	Spain	9
Guyana	1	Sri Lanka	2
Haiti	4	St. Christopher-Nevis-Anguill	1
Honduras	3	Sudan	1
Hong Kong	49	Switzerland	9
India	10	Thailand	2
Indonesia	5	Trinidad and Tobago	2
Ireland	5	Tunisia	2
Italy	16	United Arab Emirates	9
Ivory Coast	3	United Kingdom	65
Jamaica	2	Uruguay	6
Japan	30	Venezuela	4
Jordan	3	Yemen (Sana)	1
Kenya	2		
		Total	775

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[1] Source: Federal Reserve Board data bank.

TABLE B

Foreign Branches and International Banking Subsidiaries of U.S. Banks[1]

Year	NUMBER Foreign Branches[2]	NUMBER Sections 25 and 25(a) Corporations	TOTAL ASSETS (BILLIONS OF DOLLARS) Foreign Branches[3]	TOTAL ASSETS (BILLIONS OF DOLLARS) Sections 25 and 25(a) Corporations
1971	577	85	55.1	5.5
1972	627	92	72.1	6.1
1973	699	103	108.8	6.9
1974	732	117	127.3	10.1
1975	762	116	145.3	9.1
1976	731 4/	117	174.5	11.1
1977	738	122	205.0	13.4
1978	761	124	232.0	14.8
1979	779	132	290.0	16.3
1980	799	165 5/	320.0	21.3

1/ Source: Figures for 1971-1979 are taken from the 1979 Annual Report of the Federal Reserve Board. Foreign branch figures for 1980 are from the 1980 Annual Report of the Federal Reserve Board. Figures for Sections 25 and 25(a) corporations for 1980 were supplied by Federal Reserve Board staff.

2/ Includes branches in overseas areas of the United States.

3/ Data are derived from year-end reports of conditions filed with the Comptroller of the Currency and Federal Reserve System, and may differ in certain respects from other statistical reports on overseas branch operations. The amounts shown are net of claims on other foreign branches of the same bank.

4/ Decrease from 1975 was due primarily to the conversion of 30 branches in Colombia into subsidiaries to conform with Columbian banking laws.

5/ Figures for 1971-1979 are total number of Sections 25 and 25(a) Corporations. Figure for 1980 is total number of offices of Sections 25 and 25(a) Corporations, which were permitted to open domestic branch offices by regulations adopted on June 21, 1979, pursuant to the International Banking Act of 1978.

TABLE C

SUMMARY AND ESTIMATE OF THE INTERNATIONAL BUSINESS OPERATIONS OF THE U.S. BANKING INDUSTRY

(billions of dollars)

	1978	1979	1980
Total Assets of Overseas Branches **	232.0	290.0	363.5 1/
Total Assets of Edge Act and Agreement Corporations	14.8	16.3	17.9 2/
Total Assets of Overseas Offices	246.8	306.3	380.4
Total Deposits of Overseas Branches plus Edge Act and Agreement Subsidiaries of Insured Commercial Banks 4/	220.6	272.5	337.9 3/
Average Assets of Overseas Offices 5/	232.6	276.6	343.4
Overseas Offices' Interest Received on Assets 6/	19.4	26.2	42.5
Interest Paid on Overseas Offices' Deposits 7/	-14.7	-22.7	-37.7
Net Overseas Interest Income 8/	4.7	3.5	4.8
Interest Income of Domestic Offices From Foreign-Domiciled Customers 9/	2.0	2.3	2.6
Non-Interest Income Attributable to International Business 9/	1.3	1.5	1.7
Total Foreign Revenues 10/	8.0	7.3	9.1

** Net of claims on other foreign branches of the same bank; see Federal Reserve Board, 66th Annual Report, p. 285.

SOURCE: The Table was prepared by Economic Consulting Services Inc., Washington, D.C. and is included as Table C-5 in "The International Operations of U.S. Service Industries: Current Data Collection and Analysis," a final report prepared for the Departments of State and Commerce and the Office of U.S. Trade Representative by Economic Consulting Services, Inc., dated June 1981.

Table C, Page 2

1/ Estimated by applying 1978-1979 growth rate (25%).

2/ Estimated by applying 1978-1979 growth rate (10%).

3/ Estimated by applying 1978-1979 growth rate (24%).

4/ Data are available on this category of deposit after 1977 only. Assumes that 100% of deposits are interest-bearing.

5/ Average assets of overseas offices were calculated by adding the beginning-year assets to the end-year assets and dividing the sum by two. The previous year's end-year assets were used as a substitute for beginning-year assets. Not shown are the total assets of overseas offices for 1977, which were $218.4 billion.

6/ Equivalent to Gross Interest Income. Calculated as a percent of Average Assets (percentages reported in the Federal Reserve Bulletin, September 1980, p. 702, were 8.34% and 9.46% for 1978 and 1979, respectively. The preliminary 1980 percentage is 12.37% of Average Assets). The average assets which are used by the Federal Reserve Board to calculate the percentages are net of claims on other foreign branches of the same bank.

7/ Equivalent to Gross Interest Expense. Calculated as a percentage of Average Assets (percentages reported in the Federal Reserve Bulletin, September 1980, p. 702, were 6.33% and 8.19% for 1978 and 1979, respectively. The preliminary 1980 percentage is 10.99% of Average Assets). The average assets which are used by the Federal Reserve Board to calculate the percentage are net of claims on other foreign branches of the same bank.

8/ Calculated as the difference of the two preceding lines.

9/ Source: Federal Reserve Board (see text of ECS study); 1980 figure was estimated based on the 1978-1979 growth rate (15%).

10/ Calculated as the sum of the preceding three lines.

SOURCE: The Table was prepared by Economic Consulting Services Inc., Washington, D.C. and is included as Table C-5 in "The International Operations of U.S. Service Industries: Current Data Collection and Analysis," a final report prepared for the Departments of State and Commerce and the Office of U.S. Trade Representative by Economic Consulting Services, Inc., dated June 1981.

TABLE D

SELECTED ASSETS AND LIABILITIES OF U.S. OFFICES AND U.S. BANK SUBSIDIARIES OF FOREIGN BANKS 1/

	Amount ($ billions)						Share of Total U.S. Banking Assets/Liabilities (per cent)					
	Total Assets	Standard Banking Assets	Total Loans	C & I Loans	Total Deposits	Total Nonbank Deposits	Total Assets	Standard Banking Assets	Total Loans	C & I Loans	Total Deposits	Total Nonbank Deposits
December 1973	32.3	24.8	17.6	12.8	11.4	5.9	3.8	3.2	3.7	7.6	1.7	1.9
December 1974	46.1	36.9	27.0	18.8	17.0	8.2	4.9	4.3	5.1	9.5	2.3	2.6
December 1975	52.4	42.1	29.9	19.9	22.6	11.5	5.3	4.7	5.7	10.4	2.9	3.5
December 1976	61.3	48.5	35.4	19.7	26.1	18.1	5.8	5.1	6.4	10.2	3.1	2.4
December 1977	76.8	59.0	41.5	22.0	33.8	22.4	6.4	5.6	6.6	10.3	3.6	2.6
December 1978	109.1	87.6	65.3	32.7	46.3	30.8	8.0	7.3	8.8	13.1	4.5	3.2
December 1979	149.7	122.6	91.9	48.2	62.8	43.9	9.9	9.1	10.9	16.3	5.6	4.3
December 1980	200.9	164.0	121.5	59.6	80.7	61.4	12.0	11.1	13.4	18.2	6.6	5.5
March 1981	205.4	166.4	123.3	62.1	80.9	61.9	12.2	11.1	13.6	18.9	6.6	5.5

1/ Source: Federal Reserve Board Data Bank

BANKERS' ASSOCIATION FOR FOREIGN TRADE

December 28, 1981

RESPONSES TO SENATOR HEINZ'S QUESTIONS OF NOVEMBER 30, 1981

1. You suggest that the attractiveness of the U.S. market to foreign banks can be used as important leverage in negotiations to open up markets abroad. Do you know if this is being done presently?

-- Has it ever been used in the past?

-- The Japanese seem to be masters of administrative delays to block or impede access to their home market. Are you suggesting we learn from their model of behavior?

As discussed in our testimony (pp. 15-16), we believe that State reciprocity laws have been helpful, at times, in opening up banking markets abroad for U.S. banks.

The Comptroller's ability to consider State reciprocity laws in approving federal branches and agencies of foreign banks is presently the subject of litigation. The Comptroller believes that he is not bound by State reciprocity laws in licensing federal branches and agencies, and that, on a federal level, Congress rejected reciprocity in favor of a national treatment policy for foreign banks. The Comptroller's views were recently upheld in a federal district court decision here in Washington. Conference of State Bank Supervisors v. Heimann, No. 80-3284 (D.D.C., Sept. 30, 1981). This decision was recently appealed to the federal appeals court for the District of Columbia.

In suggesting that reciprocity be a factor in federal decisions on foreign bank operations in this country, we are not recommending that the agencies employ a system whereby foreign bank applications would be placed in limbo pending affirmative reciprocity determinations. We believe any such system of "denial by delay" would be counterproductive. It would indicate U.S. approval of a type of practice that we oppose, and thus might encourage its use in other markets abroad, to the detriment of U.S. banks.

Rather, we are suggesting that another country's treatment of U.S. banks is a legitimate and important public policy factor for U.S. authorities to consider in acting on foreign bank applications. Where such factor is sufficiently compelling to support the denial of an application, the applicant should be given the option of withdrawing its application or of facing a public denial on national treatment grounds.

2. Why should we be so open with regard to foreign takeovers of our largest banks, such as Marine Midland and Crocker, when there is absolutely no reciprocity anywhere with regard to large bank takeovers?

-- What do we gain?

We cannot agree with the statement in your question that "there is absolutely no reciprocity anywhere." As detailed in the Comptroller's study, U.S. banks do enjoy substantial banking opportunities in many major markets throughout the world. As indicated in our statement, however, we disagree with the general conclusion of that study which implied that U.S. banks faced relatively few important barriers abroad. As detailed in our statement, that conventional wisdom is simply not supported by the facts. While the situation is certainly not as good as implied in the Comptroller's study, it is also not as bad as you suggest. In fact, we have seen progress in a number of important markets in recent years, including especially Japan, which was the subject of much adverse comment at the time of the IBA.

On the broader aspects of your question, BAFT has generally opposed a moratorium on foreign bank acquisitions because such a policy would be inconsistent with the free flow of international trade and investment and could provoke new restrictions on U.S. banks abroad. Instead, as detailed in our testimony, BAFT believes the U.S. Government should vigorously pursue on both a bilateral and multilateral basis the adoption of the principle of equal national treatment in the foreign markets in which BAFT members operate.

3. Would you say that the major barriers to U.S. banks abroad are statutory, or are they unwritten in the form of administrative delays and run-arounds?

-- Can or should the U.S. Government help you with administrative delays and run-arounds? How?

The answer to your question depends on the market concerned. In some markets, the major barriers may be statutory; in others, they may be administrative in nature.

With respect to administrative barriers, this is one area where U.S. Government assistance can be particularly helpful, since changes in such practices can often be accomplished through an informal negotiation process. In contrast, statutory changes involve a lengthy, often difficult political process.

The Treasury Department has generally taken the lead in these types of "administrative" negotiations and its participation has been helpful. As indicated in our statement, however, these efforts have been modest in scope and could well be expanded in support of a cohesive national program designed to promote national treatment.

4. You note that there is a new priority about service export issues in the Reagan Administration. How would you characterize your past relationship with Treasury and USTR? Benign neglect?

As indicated in our statement and in our previous answer, both Treasury and USTR have been helpful in the past. It would be unfair to characterize their attitude as being one of "benign neglect." At the same time, we do believe that an expanded, more cohesive program is needed to achieve national treatment abroad in banking and other areas. We have thus been greatly encouraged by the Administration's determination to move forward on services negotiations.

5. What would you say is the major reason for U.S. banking's decline in world market shares?

-- Is it simply a result of the rebuilding of the banks and economies of our major competitors and their banks' strength in their own home markets? Or is it at least partially a consequence of restrictions that U.S. banking regulations have placed on U.S. banks in our own domestic market?

As indicated in our statement and tables attached thereto, U.S. banks have shown impressive growth abroad over the past decade. However, we have also witnessed increased competition from a greater number of large foreign banks that often come from much freer regulatory environments than apply in the U.S. Lack of geographic restraints in their home country, more generous leveraging rules, and the ability to provide a greater array of banking and other services, are all factors that have given some foreign banks competitive advantages over U.S. banks in world markets. As their own economies have expanded, as world trade has expanded, and as their presence in the U.S. has expanded, foreign banks have thus grown large and have become strong competitors of U.S. banks throughout the world.

Clearly, as it begins to weigh changes in our domestic banking laws, Congress must recognize the internationalization of world markets and the effects this has had, or will have, on the competitiveness of the U.S. banking industry in the years ahead. In particular, in examining the Glass-Steagall and Bank Holding Company areas, it is important to recognize that many other countries do not impose similar legislative restrictions on their banks, thus giving them the power to engage in a broad array of investment banking, equity investment, trading, insurance and other activities denied to U.S. banks.

6. You only touch on trans border data flow problems. Specifically, how do restrictions on that flow effect your efficiency or profitability?

Traditional banking transactions such as funds transfer and foreign exchange depend upon automated systems. New services such as cash management would be impossible without sophisticated data communications. Many of these financial services require the transborder flow of various types of information in order to provide an acceptable level of customer service and remain competitive in foreign markets.

Expansive application of privacy and data protection laws abroad can actually block the flow of information necessary to conduct the type of banking transactions described above. Restrictive telecommunications practices can frustrate the efficient conduct of banking transactions as well as greatly increase the costs of conducting such transactions, _e.g._ where banks or others are required to use foreign government-owned telecommunications systems, delays in processing information may result in significant additional costs and may actually prevent the conduct of certain transactions that have to be accomplished in a timely manner. And national policies aimed at promoting the development of local data processing industries, such as the mandatory use of local facilities to process banking data, can add significant, unnecessary costs to engaging in the types of banking transactions described above, and can lead to unnecessary inefficiencies, e.g., the use of less advanced equipment to meet local requirements.

7. Are there any particularly problem regions or specific countries where the trend in recent years has been particularly adverse? What about the Middle East, is U.S. bank market share growing or declining?

As indicated in our statement, trends vary from country to country and within regions. This is true also of the Middle East area where, in recent years, there have been examples of both more liberal and more restrictive attitudes toward foreign bank entry and operations. We do not have any market share data concerning the Middle East and thus are unable to judge whether U.S. market share in that region has been growing. Based on published Federal Reserve reports, U.S. offices and foreign branches of U.S. banks had $6.8 billion in claims on Middle East countries as of June, 1981.[1/]

[1/] See Table A63, line 29, in the Federal Reserve Bulletin of October, 1981.

8. You note that multilateral negotiations within GATT and OECD are long-term solutions. What is the time frame? Five years, ten years? Can we afford to wait that long?

To the extent that past GATT negotiations can serve as a guide, it would seem reasonable to estimate that multilateral negotiations on services will take five to ten years. We cannot wait that long. Thus, as set forth in our statement, we strongly support bilateral negotiations to reduce discrimination in banking services and believe that, especially in the short-term, such an approach holds the best chance for successful results in the banking sphere.

Senator **HEINZ**. Mr. McCouch, thank you very much.

Mr. Parker?

STATEMENT OF HENRY PARKER, DIRECTOR CHUBB & SON, INC.; INTERNATIONAL INSURANCE TASK FORCE, U.S. CHAMBER OF COMMERCE

Mr. **PARKER**. Thank you, Mr. Chairman.

I'm Henry Parker, senior vice president and director of Chubb & Son, Inc., in which capacity I manage Chubb's worldwide operations. I'm also past chairman of the International Insurance Advisory Council of the Chamber of Commerce of the United States.

Accompanying me in this room is Mr. Gordon J. Cloney, Director for Special Policy Development in the International Division at the U.S. Chamber.

Chubb is not exactly, I guess, a household word, so let me tell you who we are. We are insurance underwriters. We manage insurance companies both in the United States and around the world. Our parent, the Chubb Corp., has 6,500 employees, and we have about $2.8 billion in assets.

I have a fully prepared statement, Mr. Chairman, which I would like to submit for the record.

Senator **HEINZ**. Without objection.

Mr. **PARKER**. It seems almost redundant really to describe insurance as an important international service. Insurance, like banking and the other services, is a handmaiden of trade expansion and economic development. You take away international insurance and trade itself would slow or stop, and you would of course cripple industrial growth.

It's politically popular these days, Mr. Chairman, to point to the United States as the world's largest indigenous insurance market. Now that statement is correct—it is—but, Mr. Chairman, we'd better hustle if we want to keep that title because we started the decade of the 1970's with a 63 percent share of the free world market. We wound up at the end of the decade of the 1970's with only 48 percent.

By way of comparison, the European Common Market insurers increased their market share of free world premium income during that same period from 20 percent to nearly 30 percent.

Now there is some statistical abberation in those figures caused by the weak dollar which we experienced during the 1970's, but the trend is uncomfortably very real.

Let me, then, briefly profile the players in this world's largest but rather declining, as a share of the whole, insurance market.

There are 3,000 insurance companies and groups in the United States. Of these, only 50 do any business overseas. Of those 50, only 5 have established truly global underwriting and servicing networks.

I wonder, Mr. Chairman, how many other industries there are in the United States, which industries are truly international in nature, where less than 2 percent of the players do anything outside of the United States.

FREEDOM TO COMPETE HAS ERODED

We think the reason behind these discouraging numbers is that our freedom to compete has been eroded. The American Institute of Marine Insurance Underwriters, for example, lists over 35 countries which restrict placement of marine insurance. Another 30 countries have either nationalized their insurance industries totally or have granted monopolistic powers to their national insurers. Other foreign insurers suffer numerous discriminations in the form of special deposits, special taxes, special license or currency exchange restrictions. It is a very odious thing in our business.

Another problem is the national or regional reinsurance monopolies—reinsurance being the insurance which the insurance companies buy. There are many national reinsurance monopolies which are yet another example of foreign protectionist efforts.

Now, monopolies like that, of course, work at total cross purposes with the basic insurance function—to spread risk. The net effect of the monopoly is to drive up the cost of insurance to the consumer. The price of those offending countries' exports are inflated to reflect such increased insurance costs. Therefore those exports become less competitive in the world markets. And frankly everybody loses that battle.

Some of the specific foreign practices that we in this country are facing today—outright denial of access to foreign insurance markets, discriminatory licensing—are practices marked by procedural delays. I can well recall on a personal note having to virtually commute over a 3-year period to an Asian country to try and get a license. It was very hard and there's nothing in their law there that says you can't get one; it's just these procedural delays which foreigners do enounter there.

Branch operations may be prohibited or limited. Operating costs can be driven up by the forced use of locally incorporated subsidiaries. This may force some U.S. insurers to forego opportunities in foreign markets which could benefit U.S. trade. Numerous South American countries engage in that practice.

Foreign companies may be confined in other countries to writing a single class or line of insurance business. And under such circumstances, U.S. companies and other foreign companies cannot bring to that market the most valuable stock in trade of foreign underwriters, which is entrepreneurial enterprise and the full range of expertise they have gained in serving their own domestic customers over the years.

Other carriers include discriminatory taxes—there are a lot in the EEC countries; discriminatory deposit and capital requirements, unreasonable exchange controls—the list, indeed, is a long one.

Now since 1966, the International Insurance Advisory Council has been urging improvement in U.S. trade policy relating to international insurance and reinsurance. Our council was also the first industry group to begin to express concern about barriers to trade in services in the early 1970's. And I must say it is just an enormous thrill, for all of us to participate in these hearings and to see so many service industries, joining forces in this effort.

In bringing out these barriers to trade in services in the early 1970's, we did it with a very comfortable feeling. We did it because we were doing it against the background of the U.S. market for insurance and reinsurance, which is hospitable, and open to the alien insurer. Foreign insurers, in fact, led the development of our strong U.S. domestic business. They were here before we were.

A Government survey back in 1974 disclosed that there were at that time 174 foreign insurers operating in the United States with assets at that time of over $11 billion in the United States. I would have to guess that asset figure today would certainly be several hundred percent greater than it was in the early 1970's. Foreign private insurers are free to compete in the United States, and, Mr. Chairman, that is all our U.S. industry seeks reciprocally. We ask no special favors. We ask no advantages. We seek solely the ability to compete openly and fairly in the marketplaces of the world.

Reasonable regulatory practices are therefore not at issue. The issue is the presence of non-tariff measures in law, regulation, and administrative practice which discriminate against foreign insurers—practices that are blatantly protectionist or have an unnecessary chilling effect upon international trade in insurance.

SOARING WORLD PROTECTIONISM

Mr. Chairman, I was privileged to hear your remarks, sir, before the 67th National Foreign Trade Convention 9 or 10 days ago here in Washington. You accurately described at that time the single greatest world problem in trade as—and I hope I quote you accurately, sir—"soaring world protectionism." You said that U.S. foreign trade and investment was running into—and again, I quote—"a massive protectionist wall."

I would submit to you, sir, that international insurance or reinsurance is in the forefront of service industries affected by these protectionist trends which you so accurately described last week.

And we are all indebted to you, Senator, for reminding all of us of this great danger.

We thank you for that.

Senator HEINZ. Thank you very much, sir.

Mr. PARKER. Your earlier witness, Ambassador Brock, also joined you at that convention, and he advocated a code to cover services. He made the statement—and I hope I quote him correctly—"Others must offer the United States access to their markets as we offer them in the United States."

To this, the U.S. insurance and reinsurance industry would say "Amen" We're enormously indebted to Ambassador Brock, who has taken up the cause of the service industries. I only wish other senior officials of this administration would speak out more, as do you, the Ambassador and others are on the issue of services.

I think it follows, then, that future U.S. trade policy efforts, as these relate to insurance, should center on assuring that our insurers enjoy the basic right of nondiscriminatory access to foreign domestic markets with the accompanying obligation of conforming to local regulatory requirements that are reasonable and are fairly administered.

A future GATT negotiation might, for example, aim at multilateral commitments assuring access to domestic markets for insurance and other services, much like the GATT now does for goods, We hope and would urge here, sir, that these vital subjects be introduced at the next GATT ministeral meeting.

Now after market access is gained, we believe in our business that national treatment, rather than mirror-image reciprocity, should be the principle governing the behavior of the respective host government and its regulators toward the foreign insurers. Our policy, we feel, should seek the goal of assuring open-market competition.

Of course, multilateral negotiations are only one possible route to future liberalization of the insurance trade. Until multilateral negotiations are successfully brought about, our policy must give equal attention to reducing or eliminating barriers to trade in insurance through all available bilateral means. This is crucial, we feel, to convincing our trading partners that we want and we expect them to join us in multilateral discussions.

Other possibilities, we feel, to achieve these desired ends are for the administration to pursue in a forceful way, section 301 actions which are filed under the Trade Act. We feel that the Commerce Department and USTR should assist companies with individual nontariff trade problems. Indeed, we should compliment both Commerce and USTR. They have both been willing and anxious. They've said, "Bring your problems to us, and we will help you." We should do more of that.

Eximbank policy. Eximbank, as you know, sir, is financing exports to markets, some of which deny access to U.S. insurance companies. Insurance of marine exports into Argentina is but one of many examples we could give of trade related insurance opportunities denied to us. We question, perhaps, whether Eximbank in its financing activity couldn't perhaps bring a little more pressure to bear against some of these discriminatory market practices.

Now if the offending country is an LDC, should one, for example, consider modifying its GSP?

We've already mentioned the need for an international code for services trade.

These are some actions, we feel, that could properly be considered and undertaken at this time.

Mr. Chairman, I appreciate this opportunity to share these views on international trade in insurance and reinsurance. I'd of course be pleased to answer any questions.

[The complete statement and answers to additional written questions follow:]

STATEMENT
on
BARRIERS TO U.S. TRADE IN INSURANCE
before the
SUBCOMMITTEE ON INTERNATIONAL FINANCE
AND MONETARY POLICY
of the
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
Henry G. Parker III
November 9, 1981

I am Henry G. Parker III, Director, Chubb and Son, Inc., and a past chairman and executive committee member of the International Insurance Advisory Council of the Chamber of Commerce of the United States. Accompanying me is Gordon J. Cloney, Director for Special Policy Development in the International Division at the U.S. Chamber of Commerce and Executive Secretary of the Council.

The Chamber represents more than 191,000 members -- 187,000 small, medium and large businesses, more than 1,337 trade and professional associations, over 2,378 state and local chambers of commerce, and 44 American chambers of commerce abroad. The International Insurance Advisory Council is the international arm of the Chamber's insurance industry membership.

Since 1966, the Council has urged improvement in U.S. trade policy relating to international insurance and reinsurance -- industries which are an important part of U.S. trade. The Council was also the first industry group to begin to express concern about barriers to trade in services.

Insurance is one of the most important international service industries. Although its main function is to provide the public with means of protection against financial losses arising from unexpected events, the industry offers a range of services including risk analysis, loss prevention advice and a range of savings and investment programs. International insurance has grown and diversified as an essential part of the expansion of trade, worldwide industrialization, technological progress and economic development.

In 1980, U.S. services account trade, which includes U.S. exports and imports of services as well as investment flows, fees and royalties, totaled about $169 billion or 26 percent of all U.S. private sector trade. Moreover, the services account produced a $38 billion net surplus. This was an important offset to the $25 billion deficit suffered in merchandise trade. Recent research carried out for the government suggests that U.S. trade in services may be understated, perhaps by as much as 50 percent.

Worldwide insurance premium volume (excluding the Communist Bloc) more than tripled during the 1970s to $392 billion in 1979, of which approximately 40 percent is attributable to life and 60 percent to nonlife business. This business was transacted by approximately 10,000 domestic companies and 3,000 branch offices abroad. About 95 percent of worldwide premium was produced by the Organization for Economic Cooperation and Development (OECD) nations. The 5 percent of world premium attributable to nonindustrial countries has doubled since 1950. Overall, the growth of insurance has exceeded the pace of global economic development.

The United States' share of global service trade receipts has dropped from 25 percent to 20 percent during the 1970s. As an insurer, I am especially distressed because our country's portion of global insurance premiums fell even more drastically, from 63 percent to 48 percent in the same period while the volume flowing to our competitors rose. Although precise figures are not available, our Council estimates that foreign gross premium volume to U.S. insurers and reinsurers exceeds $6 billion annually. This could be much higher were our industry not confronted with unfair competition in many foreign markets.

The United States market for insurance and reinsurance is hospitable and open to alien insurers. However, the reverse is not always true. Denial of market access and other obstacles to the entry of our companies symbolize the attitude of many countries. Such impediments are harmful to United States interests and to international commerce.

Mr. Cloney, several members of our Council and I recently took part in a series of meetings with representatives of the Office of the United States Trade Representative and the Department of Commerce to prepare a strategy paper on insurance. One part of the paper, using Council materials, set out the principal barriers to trade in insurance. This listing of barriers is attached as Appendix A and I will highlight here some of the principal problems.

Outright denial of access to insurance markets is the most formidable barrier to trade in insurance, yet total denial is imposed in relatively few countries. But an effective substitute is often found -- discriminatory licensing practices marked by procedural delays. Such procedure plays havoc with an insurer who has developed marketing plans geared to current opportunities. Companies assume that if they meet specified conditions, they will gain reasonably prompt approval to begin operations. But months or perhaps years go by with no action except requests for further and often minor information. Sometimes the awaited license does not materialize. There is no explanation for the denial and no legal recourse for a reversal. Under such circumstances, commitments the U.S. company has made in terms of resources and staff are lost, as are the related trade opportunities.

One of the "trade-chilling" requirements imposed for access to a foreign market may be forced establishment of a local corporate subsidiary. Local ownership participation and control of the subsidiary are, in some cases, demanded. The effect of such requirements can be appreciated if you consider that many U.S. insurance companies operating internationally prefer to establish a branch office rather than a local corporation as the branch is more effective in terms of assets required and cost efficency. Operating costs are driven up by the forced establishment of subsidiaries and this may force the U.S. insurer to forego opportunities in foreign markets which could benefit U.S. trade.

Admission to a market may be followed by internal barriers addressed to foreign companies such as being confined to writing a single class or line of insurance business. Under such circumstances, companies cannot bring to the market what is perhaps the most valuable stock in trade of United States underwriters. They cannot provide the foreign market with the full range of entrepreneurial initiative and expertise they have gained in serving their own domestic customers over the years. They cannot anticipate and develop innovations to satisfy the changing needs and demands of the public seeking protection. They have no incentive to become pioneers in bringing to the foreign market new products and services.

The practices so far described do not exhaust the list of discriminatory barriers foreign countries bring to bear on United States insurers seeking entry into their markets and/or upon those U.S. insurers already in them. For example, discriminatory taxes may be levied on foreign admitted companies. And there are an array of tax practices designed and applied to discourage nationals from patronizing foreign insurers. Discriminatory taxation can convert the admitted foreign insurer into an ineffective, noncompetitive presence.

Competitive capabilities can be hurt by discriminatory deposit and capital requirements which add substantially to the foreign insurers' cost of operation. Still another discriminatory practice is the imposition of exchange controls which unfairly restrict the remittance of funds. The damaging procedures may include denial of necessary foreign exchange; bureaucratic delays in gaining permission to carry out transfers, or prohibition of payment of the component parts of an insurance transaction. Nationals can be discouraged from patronizing foreign insurers by local regulations making it impossible for them to remit payment to overseas companies because foreign exchange is unavailable.

It is generally accepted that some control or regulation of insurance is necessary to protect against financially unsound operations and to ensure fairness of contract terms and performance. Reasonable regulation and regulatory practices are not at issue here. The issue is the presence of nontariff measures in law, regulation and administrative practice which discriminate against foreign insurance, insurers and insurance intermediaries -- practices that are protectionist or have an unnecessary "chilling" effect upon international trade in insurance.

It follows that future U.S. trade policy efforts, as these relate to insurance, should center on assuring that our insurers enjoy the basic right of nondiscriminatory access to foreign domestic markets with the accompanying obligation of conformity to local regulatory requirements that are reasonable and fairly administered. A future GATT (General Agreement on Tariffs and Trade) negotiation might aim at multilateral commitments assuring access to domestic markets for insurance and other services much like the GATT provisions now do for goods. After market access is gained, national treatment should be the principle governing the behavior of the respective host government and its regulators toward the foreign insurer. Our policy should seek the goal of assuring open market competition.

Of course, *multilateral negotiations are at present only a possible route to future liberalization* of insurance trade. Until they are successfully brought about, *our policy must give equal attention to reducing or eliminating current barriers to trade in insurance through all available bilateral means.* This is *crucial* to convincing our trading partners we want and expect them to join us in multilateral discussions.

Mr. Chairman, I appreciate the opportunity to share these views on trade barriers to insurance and reinsurance and I would be pleased to respond to any questions.

From INTERNATIONAL TRADE ISSUES IN INSURANCE
U.S. Department of Commerce
October 1981

"Barriers to Trade in Insurance

Insurance companies find it increasingly difficult to gain access to foreign markets, to operate to their full capacity in such markets, or to compete on an equal basis with domestic insurance firms. A wide variety of impediments exist which restrict international commerce in insurance. These generally can be classified into two broad categories -- those affecting the provision of insurance (1) directly from abroad, and (2) from a branch or affiliate in a foreign market. Insurance operations are also affected by the restrictions which apply to investment generally. In some cases, impediments encountered stem from discriminatory or prohibitive regulations which effectively protect and promote domestic insurers. In other cases problems occur when government regulatory bodies use considerable discretion of a discriminatory nature in implementing regulatory procedures and in interpreting regulatory policies. In many countries, insurance regulations pertaining to foreign insurers are vague, sometimes unobtainable, and as such lead to arbitrary decision making.

Barriers faced by insurance firms include not only directly discriminatory measures, such as restrictions on the participation of foreign insurers in local markets and the freedom of residents to place insurance abroad, but also factors such as tax policies and exchange control regulations which may discourage foreign insurers from any participation in these markets. In addition, measures which are applied equally to both foreign and domestic insurers may have a discriminatory effect on the former due to the nature of their operations. Examples include high minimum capital requirements and requied investments in local securities. Restrictions on the employment of non-nationals are also likely to have greater impact on foreign insurers.

Barriers may be grouped into four general categories as they relate to: (1) access to market and establishment; (2) transaction and financial operations; (3) equivalent competitive position; and (4) personnel. (Restrictions on reinsurance and transportation insurance are described separately).

Restrictions on Access to Market and Establishment

Denial of Market Access -- Some governments do not allow any foreign participation in their insurance market, substantially restrict it, or are in the process of eliminating foreign participation. The most prevalent restriction on insurance placement requires that a particular line of insurance be purchased within the domestic market. In more severe cases, which are not uncommon, a prospective buyer must not only purchase locally, but with locally owned insurance firms or a state insurance agency (thereby excluding foreign admitted insurers). Regulations which restrict insurance placement involve many lines of general and life insurance.

Government Policies which Discourage Nationals from Purchasing Insurance from Foreign Entities -- While "technically" permitting foreign insurers to compete, many governments carry out policies which effectively discourage nationals from placing insurance with foreign firms. The most prevalent restriction of this type is the assessment of a tax on insurance placed outside the local market (and in some cases with foreign-admitted insurers). Similarly, some governments discourage insurance placement with foreign entities by not allowing domestic policy-holders to charge premiums paid to foreign insurers as tax deductible business expenses (although such concessions exist for premiums paid to domestic insurers), or by treating claims received on insurance policies placed outside the local market as income and thus subject to tax.

Arbitrary and Discriminatory Licensing Procedures -- Licensing is the primary means used by governments to regulate insurers. Before an insurance company can operate within a market, it must obtain a license for each line of insurance it desires to sell. Arbitrary and discriminatory licensing procedures have been vigorously applied by some governments as a means of denying foreign participation (or additional foreign participation) in the market, either totally or with respect to certain lines of insurance. Such practices often discourage foreign firms from applying for licenses.

Characteristics of such discrimination vary but may include:

- o denial of a license to a qualified foreign branch or subsidiary;

- absence of adequate written regulations or regulatory procedures, leaving extensive opportunity to use administrative discretion for protectionist purposes in considering licensing requests;
- difficulty in obtaining an explanation as to the reasons an application to obtain a license has been denied;
- lack of an administrative appeal process in cases of licensing requests being denied;
- extensive delays in processing an application to obtain a license;
- failing to process an application to obtain a license.

Discrimination Against Foreign Branch Operations -- Branch offices have traditionally been the predominant mode of operations for insurance companies in foreign markets. In recent years, some governments have moved to forbid and/or eliminate foreign branches by prohibiting any further establishment of branch operations and requiring the local incorporation of existing branches. Other forms of discrimination may include delays in granting licenses for branch operations, and blatantly discriminatory taxation of branches vis-a-vis local corporations.

Forced Localization -- In most instances, mandatory local incorporation is accompanied by national majority ownership requirements and a prohibition against branch operations. Governments can also force localization through discriminatory regulatory policies (e.g., taxes, capital requirements) which make it impossible to stay in business in branch form. If a government has prohibited further foreign investment in insurance, it can, over the long run, force divestment of foreign holdings even without officially requiring it. One way is to raise capital requirements -- requirements foreign insurers cannot comply with because additional investment is prohibited. To meet such capital requirements, a foreign investor must attract national investors and in the process dilute his percentage of ownership.

Restriction on Transactions and Financial Operations

Restrictions on Remittances -- A common practice in a number of insurance markets is a system of exchange control which unreasonably restricts the remittance of funds by insurers, intermediaries and the insured. These practices may take the form of denial of foreign exchange needed; procedural and processing delays in obtaining permission from local authorities to carry out the transfer; or prohibition upon payments of component parts of an insurance transaction.

Discriminatory Deposit or Capital Requirements Placed on Foreign-Admitted Insurers -- It is an accepted regulatory policy to require that insurance companies operating in a market meet and maintain a minimum deposit requirement. In a number of markets, however, the amount of the deposit, the form, or the manner in which it is held is more stringent on the foreign company than on the domestic company. Foreign-admitted insurers may also be subject to higher capital requirements than domestic firms and more stringent solvency criteria.

Discriminatory Taxation of Foreign-Admitted Insurers -- In a number of countries, various taxes, including income and premium taxes, fall more heavily on foreign-admitted insurers than on local insurance companies. In the case of income tax, foreign-admitted insurers may be required to pay a higher level of tax or have their taxes computed on a different, more costly basis than local companies. Other discriminatory forms of taxation may include taxes on premiums paid to foreign insurers or taxation of indemnity payments as income from abroad. The higher taxes can have a substantial impact on relative prices for insurance coverage, making the foreign insurer uncompetitive.

Restrictions on Competitive Equality

Discrimination in Government Procurement -- A number of governments require that the insurance procured by government departments, local authorities, state corporations, other government-related organizations and government contractors be placed only with local insurance companies owned by local citizens.

Exclusion of Foreign-Admitted Insurers From Trade Associations -- In many countries, trade associations provide a critical link to local regulators and market information. The exclusion of foreign companies from participation in such associations places them at a severe disadvantage vis-a-vis domestic firms. Membership in such associations also may give added prestige or credibililty to the insurance company.

Restrictions on Personnel

Restrictions on the Employment of Non-Nationals -- To be competitive it is necessary that a foreign insurance company have management, professional, and technical expertise, adequate to relate local needs to its worldwide experience and accumulated insurance know-how. This is an important and often essential dimension of competition with local firms which often have superior personal contacts, market relationships, etc. Thus, it is often necessary to complement local management and technical personnel with personnel from elsewhere within a firm or from its home office. Restrictions or unreasonable delays in obtaining work permits often act as barriers to the provision of efficient insurance services.

Restrictions on Reinsurance and Transportation Insurance

Reinsurance -- Restrictions on reinsurance placement may take many forms. Most common are compulsory internal cessions of reinsurance transactions. In some instances, governments require a fixed percentage of all reinsurance to be ceded to private companies within the local market. In other instances, reinsurance must first be offered to local companies before it can be placed outside. Some countries have established national or regional reinsurance institutions and require that all or part of reinsurance cessions made by companies be placed with the designated reinsurance entity. Other factors which may inhibit placement of reinsurance abroad include disallowance of credit for solvency computation purposes of reinsurance placed with a non-admitted insurer, and restrictions on the remittance of funds overseas.

Transportation Insurance -- Some countries have applied restrictions specifically to transport insurance. These restrictive practices range from requiring that all imports, and, in some cases, all exports be insured within the domestic market, to financial incentives (usually tax or foreign exchange regulations) which benefit the domestic market."

QUESTIONS FOR HENRY PARKER RE: Testimony of November 9, 1981

1. On page three of your statement you note that the U.S. portion of global insurance premiums fell from 63 to 48 percent during the 1970s. Is this 15 percent decline directly attributable to discriminatory practices by foreign governments or has competition from foreign insurers also increased in the last decade?

RESPONSE

This decline is due to several factors of which discriminatory practices is one. Other factors include expansion of foreign markets at a higher rate than has occurred in the United States and the downward movement in the dollar during the 1970s. Each factor's impact cannot be separated from the others, but protectionism in foreign insurance markets is an important part of the causes of this disturbing trend.

2. You mention a host of discriminatory actions practiced by foreign governments but you cite "denial of access" to insurance markets as the most formidable barrier to trade in insurance. Tell me, which countries have totally denied U.S. firms entry and which countries have imposed particularly burdensome and/or discriminatory entry requirements?

RESPONSE

The most complete and current listing by country of specific insurance trade barriers, including outright denial of access and those imposing especially burdensome or discriminatory entry requirements, is that maintained by the USTR entitled "Selected Impediments to Trade in Services - Domestic Analytical Report - Report by Action Code Within the Insurance Industry." A recent computer printout of this listing is attached for your review.

While the Socialist countries of Eastern Europe and the USSR are not listed, their governments, as non-market economies, enjoy a monopoly on all insurance, and exclude foreign insurers.

3. One of the access requirements which you cite in your statement is that one which requires a U.S. company to establish a local corporate subsidiary. In a number of industries this is not an unusual requirement. In fact, a number of U.S. companies establish local subsidiaries and/or joint ventures with host country companies or in some cases with the host government itself for the express purpose of gaining a greater share of that market. Why is this requirement particularly difficult for the insurance industry when other U.S. companies have found it not be terribly troublesome?

RESPONSE

An insurance company offers insurance coverages based upon its ability to assume risks. That ability is in turn a function of its capacity. Capacity is a mathematical concept based upon the company's capital and surplus. A Branch Office in a foreign country is, by definition, an extension of the parent company. The branch, therefore, derives and enjoys the capacity from the full financial resources of the parent insurance company. Conversely, an incorporated local subsidiary has, on a net basis, only the capacity derived from its local capitalization and surplus. Hence, to assume large risks, or indeed any risk beyond that net capacity, it must turn to other insurers via reinsurance. This complicates doing business. While it is normal for all insurers to purchase reinsurance, the volume and frequency of its purchase which small local net retentions forces, can make the subsidiary a less viable, and thus more costly, insurance vehicle. And, when, as is the case in a growingnumber of countries, that problem is compounded by compulsory state reinsurance monopolies -- another insurance trade barrier, by the way -- that subsidiary is at a distinct disadvantage. Thus, many U.S. companies, given the alternative, would operate via the branch route. Both options -- subsidiary or branch -- are available to foreign insurers entering the U.S.

4. Last month, Mr. James A. Morone, executive vice president of the American Foreign Insurance Association told the Senate Commerce Committee's Subcommittee on Tourism that "while remaining dedicated to free trade, we must guard our own domestic interests by reciprocal action against any and all who unfairly thwart our legitimate operations." Mr. Parker, do you believe that imposing reciprocity would be useful in the area of insurance, especially when, and please correct me if I am wrong here, foreign insurers have a relatively small stake in the U.S. insurance market?

RESPONSE

In my statement I supported nondiscriminatory "national treatment" as the guiding principle for dealing with foreign insurers once they have access and are admitted to a market. The United States extends national treatment and we feel other countries should do so as well. Our Council advocates a multilateral, multi-industry negotiations approach to reducing barriers to insurance (and to other services). We do not advocate creating barriers in the U.S. to foreign insurers in order to retaliate against their home governments when the latter discriminate against U.S. companies and thus do not support reciprocity in the sense it implies stroke and counterstroke behavior. There is another sense of reciprocity that derives, I believe, from U.S. multilateral trade negotiation authorities, and that is to achieve for foreign companies competitive opportunities equivalent to those enjoyed by local companies in the other country's market and vice-a-versa. This concept of reciprocity is, I suggest, compatible with national treatment.

Re your comment on the stake of foreign insurers in the U.S. insurance market, I regret not having precise current information. As I reported to your committee in my oral testimony, there were 170 foreign insurers with assets over $11 billion in the U.S. in 1974. I would guess that asset figure today to be several hundred percent greater.

5. Because insurance regulation in our country is largely reserved to the individual states, can state insurance commissioners deny access to markets if they find that the home government of the prospective foreign entrant has denied access to U.S. firms?

-- Secondly, has the U.S. insurance industry asked state insurance commissioners to deny foreign firms access to their state markets and, if so, what has been the result?

RESPONSE

There are provisions in some U.S. states which apply reciprocity in treating insurers from other U.S. states but these provisions have not been extended to insurers from foreign countries. Powers to do so by state commissioners are not clear. Very preliminary analysis by our Council suggests there is some reason to doubt this can be done in states having reciprocity provisions without further legislative clarification of what is the intention of the provisions.

In response to your second point, our industry has not asked state commissioners to deny foreign firms access to our markets. However, the National Association of Insurance Commissioners this month formed a new task force to look into discrimination against U.S. insurers operating in foreign countries. It is expected that an Industry Advisory Committee will be formed. Both groups will be organized early in 1982 and will start their review of these discriminatory practices.

6. Have our embassies abroad and the U.S. Department of State been helpful and successful in helping reduce the burdensome process of clarifying license applications and the ambiguous regulations that you must fulfill in foreign markets?

RESPONSE

In the past, it has been very difficult to generate interest in U.S. embassies about problems, such as licensing discrimination faced by U.S. insurers abroad. This situation could change given the current Administration's emphasis on services including insurance being an important part of trade. But much of the emphasis is via the USTR and unfortunately Ambassador Brock does not set priorities for the Foreign Commercial Service which is administered by the Department of Commerce, nor for our ambassadors who report to the State Department. The USTR and Ambassador Brock, together with your committee and others in Congress, have constructively embraced and are addressing the service industry trade barrier issues. Both State and Commerce should be signaling clearly this emphasis on service trade and reducing barriers to their respective bureaucracies by emphasis at the top -- at the Secretary or Under Secretary level.

7. Have U.S. insurance companies filed complaints with the Department of Commerce or with the Office of the U.S. Trade Representative and, if so, what have been the results?

RESPONSE

Some complaints have been filed, but very few. There is reason to believe that companies with international problems will turn increasingly to our government if the companies feel there is commitment to helping and a professional approach. In terms of recent issues, two "Section 301" cases have been considered, one involving insurance licensing in an Asian country produced a satisfactory solution. A "301" case involving a Latin American country's discrimination in marine insurance produced a Pyrrhic victory. The country apparently agreed to multilateral negotiations at some point in the future but meanwhile the discrimination continues unabated. This was a very weak response to blatant discrimination.

8. I assume that you would favor placing trade in insurance on the agenda of the GATT Ministerial meeting next fall. Are you satisfied that the Department of Commerce and the USTR have a large and complete enough documentation of abuses to make a strong case for the U.S. insurance industry at this time?

RESPONSE

Insurance and other services should be on the GATT Ministerial agenda and the U.S. objective should be multilateral negotiations to deal with barriers by the second half of the decade. Inability to achieve this will be a major U.S. policy failure, particularly given the Administration's current and the Congress' longstanding commitment to such a course which puts our international prestige on the line. The USTR has had, for over four years, information on insurance barriers in a large number of countries. The pattern of discrimination in many foreign markets makes, in our judgment, ample justification for action -- now.

9. As you know, multilateral negotiations often take a long time to complete. Do you think that the U.S. insurance industry might better be served through bilateral negotiations or informal discussions? Do you think the OECD could be helpful as a forum for discussion on insurance problems?

RESPONSE

We support multilateral, multi-industry negotiations both to reduce barriers and to set international standards for proper, fair treatment of insurance trade and services trade in general. These standards once they are set can be used on a bilateral level also. But bilateral negotiations alone are not enough and without agreed-to international standards, based upon a multilateral consensus, we lack the basis for calling countries to task who are using protectionist practices. Under such circumstances, the bilateral discussions will degenerate into exchanges of opinion rather than measuring conduct against an international agreed-to standard. The OECD can be helpful; however, the OECD has no enforcement capabilties. The GATT dimension, as the GATT has enforcement powers, is essential.

10. Do the same problems that face U.S. insurers in selling primary insurance (life, business insurance) also plague the reinsurance market?

RESPONSE

International trade in reinsurance is less fettered than international trade in direct insurance. However, reinsurers wishing to establish branches or local subsidiary operations in a country run into problems that are roughly the same as those faced on the direct side. And as reported earlier, a growing number of countries are reserving the reinsurance function partially or exclusively for the State, or for local national insurers only. In such jurisdictions, foreign reinsurers are totally blocked, except for retrocessions (reinsurance of reinsurance).

Senator HEINZ. Thank you very much, Mr. Parker.

Mr. Fishman?

STATEMENT OF WILLIAM FISHMAN, ESQ., SULLIVAN & WORCESTER, WASHINGTON, D.C.

Mr. Fishman. Thank you, Mr. Chairman. In view of the lateness of the hour, with your permission I would like to summarize my testimony and submit the rest of the statement for the record.

Senator HEINZ. Very well. Without objection.

Mr. FISHMAN. I am William Fishman, currently counsel to the law firm of Sullivan & Worcester here in Washington.

TRANSBORDER DATA FLOW ISSUE

For many years, and until recently, I was employed in the executive branch of government, working on a variety of domestic and international telecommunications matters. Within the last 2 or 3 years, I have spent a good deal of my time dealing with the transborder data flow issue. And it is with respect to this question that I have been asked to testify this morning.

The public policy questions which have come to be addressed under the transborder data flow label are unusually diverse, complex, and important to the United States. They are difficult to grapple with, and extremely dynamic. Elements of international telecommunications, foreign trade, foreign relations, data processing, information policy, employment, personal privacy, national sovereignty, and probably some other matters are involved. The potential impact of adverse action in this area is enormous, both for governments and for private industry. Multinational industry is particularly at substantial risk.

The importance of the issue well justifies this committee's examining it, particularly so in light of the central role of the banking industry in international commerce and trade. You are to be congratulated for expressing your interest in this emerging field, and I hope that you will continue to monitor developments in the years ahead.

Specifically, transborder data flow is a somewhat overly broad and vague rubric, but it is important to the United States for several reasons. Our economy, like all advanced economies, is becoming increasingly an information economy, as you have heard this morning, Mr. Chairman, from a number of witnesses. At the same time, it is becoming increasingly an international economy. The rapid development of international telecommunications and data processing in the last 25 years has assured that all developed economies are interrelated in a thousand ways which we take for granted on a daily basis. Trade, commerce, insurance, credit, banking, travel, and a host of other international commercial and personal activities, would be impossible in the form we know them today without the international electronic links on which they are based.

Multinational activity, I believe, is the backbone of the Western economies, and telecommunications and processing are the backbone of multinational activities. If there are problems, therefore, with respect to this structure, it behooves us to study them carefully. To their credit, many other nations, developed and Third World, East and West, have begun to recognize that the international economy is information based. They have determined that their very sovereignty in an information age is no longer simply a matter of physical boundaries and political allegiances. Rather, they recognize—correctly, I think—that sovereignty and control over one's national economy, one's national life, culture, and industry, is evolving toward questions of access to, control over, and reliance on information resources.

That goes down rather simply. But I insure you that it is a very important point. How, these nations ask, can they be sovereign, when their economic, industrial, academic, and social lives are dependent on foreign-based information resources? It is a legitimate question, and while I would not characterize these concerns as universally anti-American, it has been widely and correctly recognized that the United States is dominant in the information resource field. I believe that that dominance comes about through capital investment, risk taking, economies of scale, and sheer entrepreneurial energy.

FOREIGN MOVEMENT TOWARD SELF-ASSERTION

Having identified information resources as the key to the future, and having identified what is perceived to be foreign domination, many countries have set out to assert their own independence, both political and industrial, in this growing field. While developed countries see the issue in terms of economic competition with the United States and with other advanced countries for local and world markets, as well as the preservation of local culture, Third World countries often speak of their need to leapfrog the industrial stage of development and of the concurrent obligation of advanced economies to assist them in doing so.

Both politically and from the point of view of our trade interests, the United States may feel chagrin about this foreign movement toward self-assertion. But I think it is difficult to quarrel with the underlying anxiety of other countries.

To be more concrete, foreign governments, both the developed and developing countries, have begun to examine and in some cases to enact a wide variety of local regulatory measures, the intent and effect of which is to handicap foreign competition in the information resources area and at the same time to boost domestic capabilities. Such measures, however justifiable in the eyes of the local authorities, all too often appear to be trade barriers to the United States.

A brief and very incomplete list of such potential problem areas would include the following: Restrictions on imports of data processing systems, restrictions on export of information, restrictions on use of international telecommunications channels, domestic industry subsidies, export or import taxes on information, buy national policies, taxes on automation of plants or offices, restrictions on access to foreign data bases.

In sum, the worldwide upsurge in concern about the flow of information and its local impact creates the specter—and I would say the probability—that many countries will be considering and enacting, as time goes by, a wide variety of restrictions on the flow of information and information-related goods and services. And as you have heard this morning, that constitutes a very substantial share of the U.S. international economy, since the United States is the leading producer and exporter of such goods and services. This is a matter which demands our careful and thoughtful attention.

Yet, Mr. Chairman, there is more than mere trade at stake, however important that is. The United States has always stood for free information flow, both domestically and internationally.

We must champion that cause as much now as ever in the past. We must assert frequently, forcefully, and ubiquitously that fundamental human rights cannot be divorced from preservation of free information flow. Many other countries understand this link, even though they relinquish the lead on the issue to the United States. Unhappily, many other countries do not understand. The United States is often accused of singleminded commercialism in its advocacy of the free flow of information. I think we must, nevertheless, persevere with this position, no matter what accusations are made.

As problems and potential problems in the information flow area become more apparent, both the private sector and the U.S. Government have begun to pay increasing attention to transborder data flow. Numerous international organizations, such as the U.N., the OECD, the International Bureau for Informatics, and the International Telecommunications Union have added transborder data flow in one way or another to their agenda. Domestically, the American Bar Association, the American Bankers Association—as you have heard this morning—the Bankers Association for Foreign Trade, the International Chamber of Commerce, the National Association of Manufacturers, and others in the United States have begun to study these issues.

Although I am not a banking expert, I have always thought that the banking industry was particularly vulnerable to the growing tendency to impose restrictions on information flow, given the sensitivity of the issues with which bankers deal. Yet one often hears that up to this point there have been no clear disasters. Information restrictions have proven to be a cost of doing business. Ways have been found to minimize damage to efficient business activity on a company-by-company and country-by-country basis.

Personally, I am delighted with this news, although at the same time must tell you that I strongly believe this rosy picture will not long endure. Until now, the issue has been cast primarily in the narrow terms of personal privacy. A concerted effort in the OECD over the last 3 years has led to the widespread adoption of international privacy guidelines, and there is no imminent prospect of serious disruption with respect to personal privacy. The difficulty is that the larger issue of nonpersonal, commercial information flow is now on the agenda in the major international fora where this issue is being considered.

Many countries of all political persuasions and stages of developement are increasingly talking of restrictions on business information flows of one type or another. There is little doubt that worse is to come in terms of national policies favoring information flow restrictions. I feel that the United States, with its free market system and its penchant for ex ante problem-solving, will be caught short by worldwide tendencies to control and regulate. There will be loss of business opportunities, and there will be sharp constraints on freedom of access to information. These constraints may be economic. They may be political. They may be carried out in democratic or autocratic states. The effect on the private sector in either case will be unfortunate. What, then, is to be done?

WHAT CAN BE DONE?

First, I would urge this committee and other committees with appropriate responsibilities to clearly state congressional concerns in this area and to provide a legislative mandate to the executive branch to vigorously address the issues. I believe, Mr. Chairman, one of the prior witnesses made the same point, and I would endorse it heartily.

Congress should also increase the resources available to the executive branch to deal with this issue. I understand the need for budgetary austerity, but even a relatively small sum would go a long way to permit the U.S. Government to match other countries' governmental resources in this area. Given the stakes, the financial and human resources which are devoted to this issue today in the United States are very inadequate. I would suggest that the Department of Commerce, the Department of State, the USTR, the FCC, and perhaps other agencies of Government be given a clear legislative mandate to attack these issues, as well as the resources to do so.

Second, the private sector must find a mechanism for coalescing its own resources to attack the issue. As long as individual companies remain committed to the notion that it is unwise and unnecessary to exchange hard information with each other and with the

Government on problems encountered in this area, it will remain difficult or impossible for Government to gather adequate data, and develop the insights necessary for efficient defense of U.S. interests.

Industry must also begin to understand that this is a matter which will be with us for a long time. A short-term solution to an immediate problem does not mean that resources need not be applied to the longer term aspects of the matter. It continues to surprise me that some of the largest and most sophisticated multinationals appear to be doing little more than monitoring this issue on a middle management level.

The complaints often heard about the relatively short planning horizon of U.S. managers as against their counterparts in Japan may have some relevance here. And it is perhaps worth noting that the Japanese are carefully and very prudently positioning themselves to deal with the international information economy.

Third, I believe it is important for the foreign policy establishment to become more fully acquainted with this issue, and to gain a sharper appreciation of its importance. U.S. foreign policy must become more attuned to the information-intensive world in which we live. If it is correct to assume that the international economy and relations among States are increasingly based on information goods and services, and concepts of information sovereignty and exchange—and I do believe this is a correct assumption—then it is crucial that traditional ways of viewing foreign policy concerns, goals, and responsibilities must be adjusted to take account of these new issues and new perspectives.

It is striking that among the advanced countries the United States appears to be lagging badly in its formal recognition and demonstrated determination to make information resource policy a major element of our national and international policy.

One or two brief examples will serve to show the dangers and uncertainties that we face and the need for the United States to marshal and apply its resources. The Committee on Information, Computers, and Communications Policy of the OECD, the U.N. Center for Transnational Corporations, and the IBI have all begun to study the economic and legal implications of transborder data flow. The general thrust of these studies is to support the imposition of a new set of regulations on international information flows. The United States must begin to study this enormously complex and consequential matter.

As information systems make physical or political boundaries electronically meaningless, the international trading community must address the question whether existing international law, based as it is on relatively static and anachronistic notions of 18th and 19th century mercantile commerce, is adequate to provide a stable, predictable, and practical legal environment.

The essence of modern communications links, Mr. Chairman, is that they move data around the world at lightning speed, and can touch a dozen or 15 countries in one transaction, and all of that can take place in a second or two. Given this situation, it is debatable whether existing choice of law and conflict of law doctrines are adequate.

What law applies to data processing carried out by a computer on board a synchronous orbit satellite? Do we need new forms of remedy for information theft? For information mishandling? Do we need new rules on commercial entities' information rights and obligations? Do we need new forums in which to prosecute these matters? Do we need new lawmaking institutions? And if we do, how do we get from where we are to where we need to be? I don't know the answers. I know other countries are studying these questions, and I know the United States is not.

Similarly, the economics of transborder data flow is being studied in a number of international bodies. Although the United States is somewhat more involved in this aspect than in the legal area, we are doing too little here, too. Both the Government and private sectors are carrying out only skeletal efforts. Yet the output of these international economic studies can profoundly affect the United States, and indeed the world, economy. Direct investment decisions, capital-labor tradeoffs, and similar economic judgments may be affected by information-driven national policies.

I might emphasize, Mr. Chairman, that I am in no way attacking the dedication and skill of the people, both in Government and in the private sector, who are addressing this issue; only the adequacy of their numbers and their resources.

In closing, Mr. Chairman, I would like to add that I do not share the view of many that the United States has so far failed to articulate policy in the transborder data flow area. Recent statements of high officials of the State and Commerce Departments and of the USTR have laid out a reasonably comprehensive viewpoint.

LACKING FINANCIAL AND HUMAN RESOURCES

The five basic principles which have been described by the former Under Secretary of State as representing the essentials of U.S. policy are the following: One, free flow of information; two, protection of personal privacy; three, free trade; four, free-market forces; and five, availability of appropriate, fairly priced telecommunications goods and services.

What is lacking is resources, financial and human, to carry forward these policy guidelines, and to do the necessary work to fine-tune these goals, and protect and advance them, in the inevitable international give and take.

I have concentrated this morning, Mr. Chairman, on the business aspects of transborder data flow. There is another side to the question. It deals with the mass media. But that would take you beyond your immediate interest. I might say also that my testimony this morning only skims the surface of this fascinating and many-sided issue. I would be delighted to provide any further assistance that I can to aid you in your consideration of this issue.

Thank you very much.

[The complete statement and answers to additional written questions follow:]

Testimony of

William L. Fishman

Mr. Chairman and Members of the Committee:

My name is William L. Fishman. Currently I am of counsel to the law firm of Sullivan and Worcester. For many years and until very recently I was employed in the Executive Branch of Government working on a variety of domestic and international telecommunications matters. In recent years I have been increasingly involved in the transborder data flow issue, and it is with respect to this question that I have been asked to testify this morning. I would like to say at the outset that the views I express herein are solely my own; neither Sullivan and Worcester nor any of the firm's clients necessarily endorse them.

The public policy questions which have come to be addressed under the transborder data flow label are important to the U.S., diverse, difficult to grapple with, and extremely dynamic. Elements of international telecommunications, foreign trade, foreign relations, data processing, information policy employment, personal privacy, national sovereignty, and probably some other matters are part of the brew. The potential impact of adverse action in this area is enormous, both for governments and for the private sector; industry, especially multinational industry, is at substantial risk, even though we cannot now identify specifically on a nation by nation basis the adverse action which is on the horizon. Given the importance of the issue, it is entirely appropriate for this Commmittee to be examining it, in light of the central role of the banking industry in international commerce and trade. You are to be congratulated for expressing your interest in this emerging field, and I hope you will continue to monitor developments in the years ahead.

TBDF is important to the U.S. for several reasons. Our economy, like all advanced economies, is becoming increasingly an information economy. At the same time it is becoming increasingly international. The rapid development of international telecommunications in the last 25 years and the enormous development of data processing technology has assured that all developed economies are interrelated in a thousand taken-for-granted ways. Trade, commerce, insurance, credit, banking, travel, and a host of other international commercial and personal activities would be impossible in the form we know them today without the international electronic links on which they are based. Mutlitnational activity is the backbone of the Western economies; telecommunications and data processing are the backbone of multinational activity.

To their credit, many other nations, developed and third world, east and west, began to recognize a few years ago that the international economy was information based; a large number of foreign governments determined that sovereignty in an information age was no longer simply a matter of physical borders and political allegiance, but instead was evolving toward access to, control over, and reliance on information resources. How, these nations asked, could they be sovereign, when their economic, industrial, perhaps even academic and social lives, were dependent on foreign-based information resources. While I would not characterize these concerns as universally anti-American, it was widely (and correctly) recognized that the U.S., through capital investment, risk-taking, economies of scale and sheer entrepreneurial energy, had captured a very large portion of the world markets in information goods and services. Having identified information resources as the key to the future, and having identified what was perceived to be foreign domination, many countries have set out to assert their own independence, both political and industrial, in this growing field. While developed countries see the issue in terms of ecomonic competition for local and world markets as well as the preservation of their local culture, third world countries often speak of their need to leapfrog the industrial stage of development and of the obligation of advanced economies to assist them in doing so. Both politically and from the point of view of our trade interest, the U.S. may feel chagrin about this foreign movement towards self-assertion but I think it is difficult to quarrel with the underlying anxiety of other countries.

To be more concrete, foreign governments, both in the developed and developing worlds, have begun to examine, and in certain cases, to enact, a wide variety of local regulatory measures, the intent of which is to handicap foreign competition in the information resources area and to boost domestic capabilities. Such measures, however justifiable in the eyes of the local authorities, all too often appear to be trade barriers to the U.S. observer. A brief, and incomplete list of such potential problem areas would include the following:

- Restrictions on imports of data processing systems;
- Restrictions on export of information;
- Restrictions on use of international t/c channels;
- Domestic industry subsidies;
- Export or import tax on information;
- Buy national policies;
- Taxes on automation of plants or offices;
- Restrictions on access to foreign data bases.

In sum, the world-wide upsurge of concern about the flow of information and its local impact creates the spectre, even, I would say, the probability, that many countries will be considering, and enacting, as time goes by, a wide variety of restrictions on the flow of information and information-related goods and services. Many have already done so in one form or another. Since the U.S. is a leading producer and exporter of such goods and services, this is a matter which commands our careful and thoughtful attention. As traders we cannot assume the old rules of the road will prevail in the future. On the contrary, we must be ever more mindful of the potential barriers to international trade and we must be prepared to take action to protect our interests when and wherever necessary.

And yet, Mr. Chairman, there is more than mere trade at stake, however important that is. The U.S. has always stood for free information flow, both domestically and internationally; we must champion that cause as much now as ever in the past; we must assert frequently, forcefully, and ubiquitously that fundamenntal human rights cannot be divorced from preservation of free information flow. Many other countries understand this, of course, while relinquishing the lead on this issue to the U.S. Unhappily, many others do not understand it, and accuse the U.S. of single-minded commercialism in its advocacy of free flow of information. Nevertheless we must perservere in this respect.

As problems and potential problems in the information flow area have become more apparent, both the private sector and the USG have begun to pay increasing attention to TBDF. Numerous international organizations, such as the UN, the Organization for Economic Cooperation and Development (OECD), the International Bureau for Informatics, the International Telecommunications Union, and numerous regional organizations have added TBDF to their agendas. The American Bar Association, the American Bankers Association, the International Chamber of Commerce, the National Association of Manufacturers and others in the U.S. hae begun to study the issues. While not a banking expert, I have always thought that the banking industry was particularly vulnerable to the growing tendency to impose restrictions on information flow; banking is increasingly an information exchange process, particularly international banking. Banks also deal in particularly sensitive areas of national soveriegnty, including such matters as national credit standing, capital formation, currency exhange rates, investment policy, personal privacy and so on.

And yet, one often hears that up to this point there have been no clear disasters; information restrictions have proven acceptable, ways have been found to minimize damage to efficient business activity. Personally, I am delighted with this news, although at the same time I must tell you I strongly believe this rosy picture will not long endure. Until now the issue has been cast primarliy in the narrow terms of personal privacy. Concerted efforts in the OECD over the last three years has lead to the widespread adoption of international privacy guidelines and there is no imminent prospect of major disruption in the privacy field. But the larger issue of non-personal, commercial information flow is now on the agenda in the major international fora dealing with the issue. Many countries, of all political persuasions and stages of development, are increasingly talking of restrictions on business information flows of one type or another.

There is little doubt that worse is to come in terms of national policy favoring information flow restrictions , and I very much fear the U.S., with its free market system and penchant for ex ante problem solving will be caught short by world wide tendencies to control, to regulate, to interfere. There will be loss of business opportunities and there will be sharp constraints on freedom of access to information. These constraints may be economic and imposed in democratic states in some cases and in others will be imposed by dictatorial or authoritarian regimes. The effect on trade will be unfortunate in both cases.

What then, is to be done? First, I would urge this Committee and other Committees with appropriate responsibilities to clearly state Congressional concerns in this area and to provide a legislative mandate to the Executive Branch to vigorously address the issues. Congress should also increase the resources available to the Executive Branch to deal with this issue. I understand the need for budgetary austerity. But even a few million dollars would go a long way to permit the USG to match other countries' governmental resources in this area. Given the stakes, the current financial resources and the dozen or fewer people in the USG who work actively on this issue must be substantially increased. In sum, Commerce, State, USTR, FCC and perhaps others must be given a clear legislative mandate to attack these issues as well as the resources to do so.

Second, the private sector must find a mechanism for coalescing its own resources to attack the issues. As long as individual companies remain committed to the notion that it is unwise and unnecessary to exhange hard information with each other and with the government on problems encountered in this area, it will remain difficult or impossible for government to gather adequate data and develop insights necessary for efficient defense of U.S. interests. Industry must also begin to understand that this is a matter which will be with us for a long time; a short term solution to an immediate problem does not mean resources need not be applied to the longer term aspects of the matter. It continues to surprise me that some of the largest and most sophisticated multinationals appear to be doing little more than monitoring this issue on a middle management level. The complaints often heard about the relatively short planning horizon of U.S. managers as against their counterparts in Japan may have some relevance here. (Perhaps it is worth noting that the Japanese appear to have fully appreciated and to be very deliberately and intelligently positioning themselves for the information age.)

Third, I believe it is important for the foreign policy establishment to become more fully acquainted with this issue and to gain a sharper appreciation of its importance. U.S. foreign policy must become more attuned to the information-intensive world in which we live. If it is correct to assume that the international economy and relations among states are increasingly based on information goods and services, and concepts of information soverignty and exchange, and I very much believe this is the case, then it is crucial that traditional ways of viewing foreign policy concerns, goals and responsibilities must be adjusted to take account of these new issues and new perspectives. It is striking that among the advanced countries, the U.S. appears to be lagging badly in its formal recognition and demonstrated determination to make information resource policy a major element of our national and international policy. We cannot afford such a circumstance indefinitely.

One or two brief examples will serve to show the dangers and uncertainties we face, and the need for the U.S. to marshall and apply its resources. The Committee on Information, Computers and Communications Policy in the OECD, the UN Center for Transnational Corporations, and the IBI have all begun to study the economic and legal implications of TBDF. The general thrust of these studies is to support the imposition of a new set of regulations on international information flows. The US must begin to study this enormously complex and consequential matter. I myself have devoted some attention to the legal issue. As information systems make physical or political boundaries electronically meaningless, the international trading community must address the question whether existing international law, based as it is on relatively static and anachronistic notions of 18th and 19th century mercantile commerce, is adequate to provide a stable, predictable and practical legal environment:

> "Since ancient times, and until the emergence of modern national states, the law governing

> maritime commerce had been largely uniform in the western world. In the eighteenth and nineteenth centuries, however, legislative enactments and judicial practices of pursuit of narrowly conceived national interests gradually displaced in various countries the venerable and uniform "law of the sea" and gave rise to sharp conflicts of laws. The movement of goods from country to country was thus hampered at a time when advancing technology and the spreading industrial revolution were about to lead to an expansion of maritime commerce on a world scale. (Citation omitted.)[1]"

When an electronic message is generated in country A, switched in country B and C, transits country E, F, G, and H, processed in country I and J, stored in country K, and involves entities residing in or operating in yet other countries, it is debatable whether existing choice of law and conflict of law doctrines are adequate. What law applies to data processing carried out by a computer on board a synchronous orbit satellite? Do we need new forms of remedy for information theft? For information mishandling? Do we need new rules on commercial entities' information rights and obligation? New fora in which to prosecute these matters? New law-making institutions? If so, how do we get there?

- Bilateral arrangements;
- Multilateral arrangements;
- Private contract law;
- World Conference;

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[1] Yiannopoulos, The Unification of Private Maritime Law by International Conventions, 30 Law and Contemporary Problems 370.

I do not know the answers; I know other countries are studying these questions and I know the U.S. is not, either in government or in the private sector.

Similarly, the economics of TBDF is being studied in a number of international bodies. Although the U.S. is somewhat more involved in this aspect than in the legal area, we are doing too little here too -- both government and private sector are running a skeletal effort. And yet the output of these international studies can profoundly affect the U.S. and indeed the world economy. Direct investment decisions, capital/labor tradeoffs, and similar economic judgements may be affected by information-driven national policies.

In closing, Mr. Chairman, I'd like to add that I do not share the view of many that the U.S. has so far failed to articulate policy in this area. Recent statements of high officials of the State and Commerce Departments and of the USTR have laid out a reasonably comprehensive viewpoint. What is lacking is resources, financial and human, to carry forward the policy work necessary to fine tune those goals and to protect and advance them in the inevitable international give and take.

My testimony this morning only skims the surface of this fascinating and many-sided issue. I would be delighted to provide any further assistance I can to aid Congress in its consideration of this issue.

RESPONSE TO ADDITIONAL QUESTIONS SENT TO MR. FISHMAN

Q. 1. Mr. Fishman, at the end of page six of your prepared statement you predict that, "There is little doubt that worse is to come in terms of national policy favoring information flow restrictions" and that the U.S. will be caught short. You go on to say that, "There will be loss of business opportunities and there will be sharp constraints on freedom of access to information."

I understand that Canada has enacted a law that could adversely affect U.S. banks operating there with regard to the processing of accounting records. Also, I understand that both Norway and Brazil have instituted licensing and/or review procedures relative to data collection and transmission.

Tell me, do you expect more countries to formalize transborder data restrictions in the next one to three years? What types of restrictions do you believe will come first or could the list of possible restrictions you list on page 4 occur almost simultaneously?

A. 1. It seems likely other countries will be enacting data flow restrictions of one kind or another in the next few years. In some cases, these restrictions will be accurately described as precisely that; in other cases, there will be an accompanying rationale which may not in so many words acknowledge the effect or thrust of the regulation. It would be difficult to predict which of the potential barriers will be adopted by any particular country. It should be emphasized that the barriers mentioned in my testimony were intended only to be examples of the kind of governmental action the U.S. must be on the alert for.

Q. 2. It is my understanding that the U.S. favors the OECD's guidelines relative to the need for insuring the privacy of data. Do you believe that adherence to such guidelines can prevent the formal institutionalization of restrictions of data flow?

A. 2. The Guidelines appear, for the moment, to have satisfied international concern for personal privacy protection so far as export or import of data to the U.S. is concerned. The strong showing made by the U.S. in support of the Guidelines will undoubtedly forestall some foreign data flow restrictions. But they do not, of course, address the larger issues involved in non-person data flow, and I doubt they will have any impact on commercial or other non-personal data flows.

Q. 3. You state on page 7 of your statement that the Congress should "provide a legislative mandate to the Executive Branch to vigorously address the issues." Are you saying that the government is presently unprepared to address the questions of transborder data flow and if so, what do you believe should be included in a mandate to insure that the government properly addresses the issue?

A. 3. The problem at the moment in the Executive Branch is that TBDF is getting too little attention and too few resources. The value of a Congressional mandate is that it provides a spur to allocate resources, including the most valuable of all resources, human energy and creativity. With reduced budgets and staff, allocation decisions are increasingly necessary and traditional issues appear to be favored as compared with emerging ones. A Congressional statement of recognition of the importance of TBDF would help to correct the tendency to downplay TBDF. However, it seems neither practical nor fair to add heightened awareness to an issue without providing at least minimal financial resources to deal with it. Therefore, the mandate should include Congressional recognition of the long term importance of the issue to the U.S., and some financial resources to commit to its study.

Q. 4. Assuming that the Administration receives a clear mandate or perhaps clarifies its present mandate to attack the issue, how would you "launch" the attack? What would be your suggested priorities?

A. 4. Priorities should include some or all of the following:

a. Study of the constituent components of the issue as outlined in my recent testimony, and elsewhere;

b. Formulation of USG policies and positions on each of these subissues, for presentation in bilateral and international contexts;

c. Creation of a functioning interagency group at the working level, and another at the highest policy levels, to address the issue in a systematic and coherent way. The basic will for such groups now exists in the government, but some outside influence appears necessary to make these mechanisms meaningful;

d. More cooperation with the private sector should also become a part of the Administration's efforts. See the response to question 5, below;

Q. 5. How can the private sector coalesce its resources in order to build a consensus to "attack" the issues? Should these efforts be coordinated with the U.S. government or could they be equally effective in working quietly with host governments abroad?

A. 5. A focal point for private sector contribution on the TBDF issue is vital, particularly as a way to make the private sector a more significant contributor to the development by government of its policy. In recent testimony appended hereto on H.R. 1957 I outlined an advisory committee role for the private sector.

While the private sector can and should do more to mobilize itself on the TBDF issues, I do not believe that long term solutions are possible without close government involvement, since the issue is almost everywhere but the U.S. being driven by governmental concerns. It is a mistake for private players to expect to be able to meet their commercial needs in the broad sense in direct dealings with foreign governments.

Q. 6. Some persons close to the transborder data flow issue have stated privately that many countries' concern over privacy of data is really a red herring and that their real objective is to restrict U.S. data processors so that they can get a piece of the action in the so-called move from an industrialized to an information-based international economy.

Do you agree with this view and if so, how do you believe the U.S. should prepare to meet data flow restrictions, in as much as this country is the acknowledged leader in advance data processing and telecommunications technologies?

A. 6. The view described is indeed held by some. So far as personal data is concerned, I have concluded that it is an exaggeration. However, the issue has now become one of non-personal data and there is no question but that other countries are attempting to limit U.S. penetration of their domestic information resources markets. Whatever the modalities and details of U.S. policy in this area, the central thrust should be to protect free flow of information and free trade.

Q. 7. Are European and other developed countries capable of replacing U.S. data processing technology and transmission networks with their own systems? If not, it would appear, at least in the near term, that they would be doing themselves a disservice either directly or indirectly by placing restrictions on U.S. services which would result in uneconomic and ineffcient end results. Do you believe this analysis of the situation is accurate?

A. 7. The situation is extremely complex, and varies considerably from country to country. The U.S. no longer enjoys the enormous technological lead it had a decade ago in many information resource fields. Given the openness of our society, and our esposal of free trade, it will always be difficult and uncertain to try to keep technological innovation at home. In many cases it is impossible, and in some instances innovation is as robust overseas as it is here. Many countries may feel that higher costs or lower capacity in domestically-engineered and manufactured systems is a reasonable price to pay for the benefits they perceive in boosting their domestic information industry. It would not be wise to expect other countries to rely on U.S. goods and services simply because they are cheaper or better. Such an assumption reflects U.S. priorities but not necessary those of others, and will in all likelihood prove unwise. The strong drive in countries like India and Brazil to develop domestic high-technology industries in the information sector even at enormous cost to the local economy illustrates this point.

Q. 8. I note that on page 8 of your statement you say that, "the Japanese appear to have fully appreciated and to be very deliberately and intelligently positioning themselves for the information age." I suspect that no one knows this better than the folks at Control Data. I understand they spent years negotiating with the Japanese before they were finally permitted to obtain an international circuit between Japan and the U.S.

I raise this point because of the implications for new or smaller firms who may wish to enter the data processing or a related field overseas and do not have the resources of a company like Control Data. Do you believe that smaller firms who do not have the staying power of a major firm could well be eliminated from competing in foreign markets?

A. 8. Yes. More likely, the perceived difficulty of a successful initial foray into foreign markets inhibits such ventures in the formulation stage. This means U.S.

industry loses opportunities or is damaged but there is no public record or public perception of it.

Q. 9. In your closing comments, you state that you do not share the view of many that the U.S. has so far failed to articulate a policy toward the flow of information across borders. Yet on page 9 of your statement you say, "It is striking that among the advanced countries, the U.S. appears to be lagging badly in its formal recognition and demonstrated determination to make information resource policy a major element of our national and international policy."

Assuming that the preamble to our policy is the free flow of information, what do you suggest as the best way for the administration to make information resource policy a major element of domestic and international policy?

A. 9. The steps suggested above in response to question four would go a long way to accomplish the goal. The problem is one of a critical mass of public and private concern which is visible and coherent. Until there is such a critical mass, government will not take the issue seriously; until the issue is taken seriously, it is hard to develop the critical mass. This is why a clear Congressional statement of policy and support for TBDF is so vital. I refer again to the attachment hereto in which it is suggested that creation of a high level position in the State Department is vital to assure adequate attention to this issue.

Q. 10. Do you believe that the industrialized nations such as members of the European Community are prepared to seriously negotiate a formal policy on transborder data flow at this time? I ask this because some officials state that member states have not built a consensus on how to approach non-tariff barriers to services in general.

A. 10. The Europeans are not yet ready to proceed with serious negotiations; they will be, within approximately a year prepared for discussions and exchanges of policy views. Perhaps two to three years in the future they will be ready to adopt governmental and international policy.

Q. 11. Do you believe that the question of transborder data flow should be placed on the agenda of the GATT Ministerial meeting next Fall or do you believe it is better to handle the issue through less formal bilateral and or selective multilateral negotiations?

In fact, do you think that informal discussions may be the best way to proceed at this time?

A. 11. I would defer to others with a more intimate knowledge of GATT with respect to this question. It should be noted, however, that GATT is only one aspect of the problem. If the U.S. is to approach the TBDF issue comprehensively any GATT discussions would have to be part of a large set of concerns and desired solutions. It can well be an important element, but it cannot, in my view, be the only forum in which the TBDF issues are addressed.

Q. 12. Do you believe that opportunities exist for the U.S. to use our superiority in the emerging information-based international economy for aiding less developed countries through cooperation in data processing and information sharing? In short, could information processing and information sharing be an important element in developing stronger North-South relationships?

A. 12. I would hope this possibility exists. To date, LDC's appear to be so concerned about foreign domination in the information resource field that a true dialogue may be difficult or impossible. Private sector involvement, which is crucial, cannot stray too far from commercial concerns and commercial goals; yet LDC's have expressed little willingness to acknowledge the legitimacy of those concerns and goals. However, the Third World is fully aware of the importance of the TBDF issue, and a U.S. approach to them which is constructive, thoughtful, and mutually rewarding should be carefully studied.

The rewards, both politically and economically for establishing sound relationships with LDC in this field can be enormous. It should be borne in mind that the creation of world-wide access to information and a multiplicity of points of view is an important part of the American political dogma. Our struggles for political freedom around the world cannot but be advanced by helping emerging nations and economies to join the international information ecomony.

Senator HEINZ. I just want to say that all four of you, backed up and accompanied by various people in the audience, have made an invaluable contribution to our understanding of this issue.

I note, Ms. Spero, you mentioned several studies that the United States had sponsored previously in our trade negotiations. I hope you will tell us, in response to my questions, what kind of studies you think we should be doing now. They may be similar to that which Mr. Fishman is applying, or they may be different.

Mr. Parker, you indicated that people might advance our cause if more people in the administration spoke out. You said you weren't addressing yourself just to Ambassador Brock. You gave rather good marks to him.

Mr. PARKER. Indeed.

Senator HEINZ. I hope you will indicate to us the kind of things you would like to see pursued, opportunities missed, so to speak. You indicated that maybe we should do more in the way of 301 actions. Do you have any examples of opportunities there that should have been taken? We'd appreciate that. I thought your suggestion concerning general system of preference modifications indicates, possibly, a means of achieving better national treatment for U.S. firms.

Mr. McCouch, you clearly put a tremendous amount of thought and effort into your testimony. There are many tables attached to what you have done.

By the way, I'd be remiss if I didn't thank you and your organization for the enormous amount of help that you have given this committee, both Senator Stevenson, my predecessor, and myself, on such initiatives as the export trading companies legislation. And I am very indebted to you and the people who accompany you, such as Tom Farmer and Gary Welsh, whom I know have worked long and hard on this, as well as other matters.

I think, Mr. Fishman, your insights are extraordinarily profound and very, very valuable, and I think will serve the committee in good stead. I note in particular the fact that you are admonishing us not to be absent from these discussions where, in effect, people are saying, "We want a good deal more control over our lives," and that means over us, here in this country, and our particular dedication to the free-market system is more threatened by that assertion of control.

In all these areas, and others, I will have some questions I wish to submit to you for our record. But let me just say on behalf of my colleagues on the committee that you have all just given tremendous time and attention, and detailed thought, to what you have presented to us today, and we think this will be extremely valuable. And while many of the operating aspects of further legislative development may lie in large part in the Senate Finance Committee, fortunately—for myself, at least—I am a member of that committee, and a member of the International Trade Subcommittee thereof. So, if you think that you should really be testifying in two places, to that extent, you already are.

Thank you very much for being with us here today. We really appreciate it.

[Whereupon, at 12:30 p.m., the hearing was adjourned.

QUESTIONS FOR U.S. TRADE REPRESENTATIVE BROCK

1. Because of the diversity of industrial sectors within the so-called "services" group, how are you proceeding to build a consensus for a United States position with regard to the elimination of non-tariff barriers?

Answer. Your assertion that there is diversity within the services group is quite correct. However, as we found in the goods sectors, there are certain problems which are common to many or all of the international service industries. It is these common problems which link otherwise diverse industries and the common search for solutions which provide the foundation on which to build a U.S. consensus.

Essentially the Administration is attempting to establish fair and open markets for both our service industries and the service industries of other nations. In looking at the problems of service industries operating in the international marketplace it became apparent that some of the issues were common to at least two and sometimes more of the service sectors. For example, many industries have difficulty establishing operations in foreign countries. In other cases service companies can establish operations but because of local law, custom, or practice cannot gain actual access to the market. In still other cases national regulations or standards prevent U.S. companies from doing business in foreign countries.

Some of these issues are currently addressed by existing international regimes—sometimes successfully, sometimes unsuccessfully. More often than not, however, the problems are handled on a country-by-country, industry-by-industry basis.

The approach we are proposing establishes a set of broad accords outlining trade principles to which countries can subscribe. Such accords can be general trade pledges outlining the sort of market environment which is desirable or they can be more specific addressing such finite areas as taxation, customs procedures or technical standards.

We envision these accords as augmenting existing frameworks as well as providing solutions where no framework exists. The purpose of our approach is to facilitate and strengthen our existing frameworks, not to supercede them.

Recognizing this fact and recognizing that additional trade tools will help achieve our common goal, we expect and are receiving a great deal of support from the domestic private and public sector in establishing a U.S. consensus.

2. Some officials at the European Community in Brussels have said privately that the EC's Commission is not set up to deal with services and in fact has not achieved much success at liberalizing services transactions among EC member states.

Do you believe that is generally accurate and if the EC is not prepared to look at this issue how can European states participate? Would we be looking at the OECD as a forum or approach bilateral and multilateral possibilities?

Answer. It is true that many of the service industries in the EC are regulated by the Member States exclusively with very little Commission authority. However, international liberalization of services is mandated by the Treaty of Rome, and the EC Commission is continuing its efforts to realize that goal.

Externally, the EC has recognized the need to address services trade issues. At their quadripartite meeting at Key Biscayne in January, Trade Ministers from the EC, Canada, Japan and the United States agreed that services trade issues should be addressed at the GATT Ministerial this November. With respect to the OECD, it is our intention to continue our work there as a parallel effort to what we are doing in the GATT. The OECD, through its specialized committees, is uniquely equipped to examine problems of individual service sectors as well as to consider the broad trade questions affecting them.

3. Reportedly, our major trading partners remain relatively unenthusiastic over efforts to liberalize trade in services. What forms of leverage do we possess to bring about some actual results on the issue, so that we can get away from just jawboning our allies? What are we doing, and what can we do to bring about results?

Answer. There are two things that we can do to obtain better leverage internationally in the services area: (1) Enactment of services legislation that will provide the necessary tools to deal with foreign barriers to services industries; (2) Intensified bilateral efforts to raise services issues on a regular basis with those trading partners with whom we regularly deal. For example, at the U.S./Japan Trade Subcommittee meeting in December 1981, and March 1982, Deputy USTR David Macdonald raised a number of bilateral services issues with the Japanese. As a result, we are hopeful that when the Japanese reconsider their list of actions taken to remove non-tariff barriers and liberalize their market, some services trade actions will be included. Similarly, we will be raising a number of services trade issues with the Koreans at our bilateral subgroup meeting later in March.

This is the sort of process that will encourage discussions in the GATT to develop a set of principles under which we should live in the services area. Our long range goal, of course, is to be able to assert our leverage multilaterally.

4. From your discussions, do you believe that ASEAN member states are prepared to address the question of non-traiff barriers to services exports?

Answer. Most countries, particularly the developing countries, have not focused on specific aspects of barriers to services exports. The ASEAN countries generally appear to be receptive to suggestions for exploratory discussions, but have not given any firm indications as yet. Because of the wide variety of activities encompassed in the concept of "services," officials in many countries have had difficulty in envisioning the scope of discussions that would be involved. Some countries, including the ASEAN countries, are just beginning to take a closer look at the types of businesses involved in service sectors. We will continue to include services in discussions with ASEAN officials on any occasion that would be appropriate.

5. What are the chief disincentives to U.S. service exports that we in this country are guilty of? How are we shooting ourselves in the foot?

Answer. Federal taxes and anti-bribery laws are examples of disincentives to services "exports". Although some income is exempted under new tax laws, U.S. citizens are reluctant to accept work overseas because a portion of their income could be taxed twice. American businessmen also are hesitant to make certain expenditures overseas—even though their intentions are good—because they fear they may be violating the Foreign Corrupt Practices Act. In general, many of the disincentives to exports of goods apply to exports of services as well.

6. A big part of the service sector of the economy is government. This Administration, appropriately so, is trimming back the government. What impact will that have on the service sector? Can the export support group for services absorb the freed-up resources resulting from the government reductions?

Answer. The Federal Government represents a much smaller share of our national output than is generally realized. In 1981, approximately 3 percent of the U.S. Gross National Product originated in the Federal Government. Federal employment was a correspondingly small share (3 percent) of total (non-agricultural) employment in 1981. The trimming back of services produced by the Federal Government can therefore be expected to have little direct effect on the aggregate output of the U.S. service sector.

The situation is much the same when the Federal Government is considered as a purchaser of services in the economy. Total Federal Government purchase of nondefense goods and services together amounted to $76 billion or bearly 2.6 percent of total GNP in 1981.

The size of the Federal Government in terms of budgetary receipts and expenditures is, of course, a much larger share of U.S. GNP, but it is not a measure of Federal Government production or consumption of goods and services. To the extent that Federal transfer payments and tax receipts are restrained, there is little reason to believe aggregate demand for private services in the U.S. economy will decline.

7. The United States, along with the Common Market countries, are building up an incredibly huge trade deficit with Japan. Can that be off-set by trade in services? What are the major Japanese barriers to the trade in U.S. services?

Answer. There are no natural market forces which tend to balance bilateral trade flows, either at the level of merchandise trade or total trade in goods and services. Our problem with the Japanese is not the large U.S. merchandise trade deficit with Japan per se but rather Japanese government policies which block the entry of some U.S. exports and unfairly contribute to this trade imbalance. It is these Japanese Government practices—whether in the goods sector or service sector—which we are attempting to reduce.

On a multilateral basis, there is a tendency of a country's merchandise and services trade balances with the rest of the world to be offsetting. For example, the United States recorded a merchandise trade deficit of $27.8 billion in its balance of payments accounts for 1981. Although data for total goods and services is currently only available for the first three quarters of 1981, these suggest that U.S. balance of goods and services together will be a surplus by more than $12 billion for the full year. Surpluses in services trade, including earnings on investment, in the U.S. case are more than offsetting merchandise trade deficits. For Japan, a net merchandise trade surplus of $14.3 billion in the first three quarters of 1981 more than offset the Japanese deficit in services to produce an overall surplus for goods and services of $4 billion.

Attached for information is a copy of the USTR inventory of impediments to trade in services in Japan.

8. A Columbia University study shows that services now account for 67% of the U.S. GNP and 70% of employment, yet services have remained at only about 30% of the total U.S. exports for several years. What accounts for that? Is it that we just are not identifying a large amount of our services trade, or do they continue to lay

proportionately behind our other trade sectors? Why do services occupy a smaller share—less than one-half—in our exports than they do in our overall economy? Or is this merely a result of the way we gather our statistics?

Answer. There are at least three reasons for the proportionately smaller share of U.S. services production going to export than goods production.

First, the services trade sector has not been subjected to the process of successive reduction in trade barriers which has taken place in merchandise trade since the war. Services trade is hence more restricted internationally than merchandise trade, resulting in lesser opportunity for U.S. service sector exporters than for merchandise exporters.

A greater proportion of service sector activities than goods production has traditionally been non-tradable. Many personal services such as haircutting and family counselling—to choose but two examples—are hardly susceptible to export. For this reason, services may never represent a share of U.S. exports fully equal to their share of U.S. GNP. It is worth noting, however, that modern technology, especially in the area of communications, are creating new possibilities for international exchange in services. For example, technical drawings done in Pakistan to the specifications of U.S. engineering firms for projects in third countries is a phenomenon only made possible by the computer and satellite communication.

Lastly, the current inadequacies of current data collecting and reporting methods may be resulting in an understatement of the relative size of service in overall U.S. exports. Improved data would greatly help reduce this source of doubt about the actual level and composition of U.S. trade in services.

Column One
Type of Issue

1. Issues concerning the conditions under which a service company can establish itself or operate in a foreign country.
2. Issues concerning the conditions under which a non-resident service company can perform services in a foreign country or maintain support facilities.
3. Issues concerning the conditions under which service companies can sell services performed outside of a foreign country to residents inside that country.
4. Issues that cannot be classified pending further information.

Column Two
Impact on Trade

1. Restrictions on goods which have a major impact on the sale of services.
2. Restrictions on services which have a major impact on the sale of goods.
3. Not applicable

Column Three
Description of Action

1. Prohibition against offering and providing service.
2. Quantative or qualitative restrictions on service company operations.
3. Discriminatory licensing practices and procedures.
4. Discriminatory taxation.
5. Discriminatory government procurement practices and policies - both overt and convert.
6. Subsidies - direct and indirect.
7. Discriminatory standards requirement.
8. Transparency, notification and due process.
9. Discriminatory capital requirements.
10. Personnel restrictions regarding domestic personnel.
11. Personnel restriction regarding foreign personnel.
12. Foreign personnel restrictions regarding professional qualifications.
13. Discriminatory tariffs and customs procedures.
14. Discriminatory foreign exchange restrictions.
15. Copyright and trademark infringments.
16. Government induced or sanctioned policies which place foreign companies at a competitive disadvantage as compared to national firms.

DATE 07/20/81
TIME 16:47:21

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INDUSTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY	COUNTRY DETAIL
ACCOUNTING	02	PROCEDURES OR REQUIREMENTS BIASED AGAINST FOREIGN SERVICE FIRMS	JAPAN	ALTHOUGH AMERICAN FIRMS MAY PRACTICE LOCALLY, ONLY LOCAL ACCOUNTING FIRMS CAN SIGN AUDIT REPORTS IF AUDITED COMPANY IS PUBLICLY REGISTERED LOCALLY
BANKING	02	ESTABLISHMENT OF NEW BRANCHES OR SUBSIDIARIES IS INFREQUENTLY GRANTED. (*REPRESENTATIVE OFFICES PERMITTED WITH APPROVAL IN SOME CASES)	JAPAN	
BANKING	02	FINANCIAL ACTIVITIES OF FOREIGN BANKS LIMITED	JAPAN	CANNOT ENTER RETAIL BANKING. CENTRAL BANK'S REDISCOUNT FACILITIES FOR EXPORT TRANSACTIONS NOT EXTENDED TO FOREIGN BANKS.
BANKING	02	LICENSE OR APPROVAL REQUIRED FOR ESTABLISHMENT OF NEW BRANCHES OR REPRESENTATIVE OFFICES	JAPAN	
TELE-COMMUNICATIONS, DATA PROCESSING AND INFORMATION SERVICES	11	INCOMPATIBLE PERSONNEL STANDARDS DUE TO HIRING RESTRICTIONS OR QUOTAS	JAPAN	
TELE-COMMUNICATIONS, DATA PROCESSING AND INFORMATION SERVICES	02	CREDIT RESTRICTIONS	JAPAN	
TELE-COMMUNICATIONS, DATA PROCESSING AND INFORMATION SERVICES	07	INCOMPATIBLE SOFTWARE STANDARDS	JAPAN	

USTR COMPUTER GROUP

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INDUSTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY	COUNTRY DETAIL
TELECOMMUNICATIONS, DATA PROCESSING AND INFORMATION SERVICES	15	LACK OF PATENT AND COPYRIGHT PROTECTION	JAPAN	
TELECOMMUNICATIONS, DATA PROCESSING AND INFORMATION SERVICES	03	LICENSING RESTRICTIONS	JAPAN	
TELECOMMUNICATIONS, DATA PROCESSING AND INFORMATION SERVICES	14	FOREIGN EXCHANGE RESTRICTIONS	JAPAN	
TELECOMMUNICATIONS, DATA PROCESSING AND INFORMATION SERVICES	02	NETWORK CONTROLS: RESTRICTIONS ON THE AVAILABILITY OF LEASED LINES	JAPAN	VARIOUS POLICIES AND ADMINISTRATIVE PRACTICES TO DISCOURAGE OR DENY THE LEASING OF PRIVATE CIRCUITS
TELECOMMUNICATIONS, DATA PROCESSING AND INFORMATION SERVICES	02	NETWORK CONTROLS: RESTRICTIONS ON THE DEGREE OF INTERCONNECTION OF PRIVATE LEASED LINE BY DATA PROCESSING AND DATA BASE SERVICE VENDORS	JAPAN	PRIVATE LEASED LINE AVAILABLE TO DATA PROCESSING AND DATA SERVICE VENDORS ON CONDITION THAT THE CIRCUIT ONLY BE CONNECTED TO A SINGLE COMPUTER SYSTEM IN A SINGLE LOCATION ABROAD
TELECOMMUNICATIONS, DATA PROCESSING AND INFORMATION SERVICES	06	GOVERNMENT SUBSIDY OF DP INDUSTRY	JAPAN	PROTECTION OF GOVERNMENT PROVIDED DCS (NTT) FOSTER LOCAL INDUSTRY THROUGH GOVERNMENT (MITI AND NTT) PARTICIPATION IN R AND D
TELECOMMUNICATIONS, DATA PROCESSING AND INFORMATION SERVICES	13	TELECOMMUNICATION RATES AND RATE INCREASES PREDICATED ON CONSIDERATIONS OTHER THAN COST	JAPAN	

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BUILDING, CONSTRUCTION & ENGINEERING	02	A FOREIGN CONSULTING ENGINEER MUST HAVE LOCAL REPRESENTATION	JAPAN	INDIVIDUAL FOREIGN ENGINEER IS NOT REQUIRED TO HAVE A LOCAL REPRESENTATIVE, ANY ESTABLISHED CORPORATION ON A CONTINUING BASIS MUST HAVE A LOCAL REPRESENTATIVE & ESTABLISH A REGISTERED BUSINESS OFFICE WHICH REQUIRES COMPLEX ADMINISTRATIVE APPLICATION
BUILDING, CONSTRUCTION & ENGINEERING	06	TAX BENEFITS, FINANCING OF PRE-BID SURVEYS, INSURANCE AGAINST COST INFLATION ON CONSTRUCTION CONTRACTS WHICH ENABLE SOME DOMESTIC CONCERNS TO ENJOY A COMPETITIVE ADVANTAGE OVER FOREIGN FIRMS BIDDING FOR CONTRACTS IN THIRD COUNTRIES	JAPAN	
FRANCHISING	02	RESTRICTIONS ON CONTRACTUAL FREEDOM OR EXCLUSIVITY RIGHTS	JAPAN	AUTHORITIES MAINTAIN THAT FOREIGN FRANCHISORS NOT RESTRICT HIS FRANCHISE FROM HANDLING COMPETITIVE PRODUCTS
FRANCHISING	08		JAPAN	AN AGREEMENT CAN BE CANCELLED SHOULD THE GOVERNMENT DETERMINE THAT IT HAS BEEN MODIFIED OR CHANGED IN PRACTICE CONTRARY TO THE TERMS UPON WHICH IT WAS REGISTERED. LOCAL LEGAL COUNSEL ON A CONTINUING BASIS IS ALMOST A NECESSITY
INSURANCE	02	LIMITATIONS ON FOREIGN EQUITY IN A SERVICE FIRM	JAPAN	DETAILS REQUIRED

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INSURANCE	08	FAILURE TO EXTEND NATIONAL TREATMENT TO FOREIGN SERVICE INDUSTRY OPERATIONS	JAPAN	THERE IS A MINIUM STATUTORY DEPOSIT REQUIREMENT TO THE FOREIGN INSURER OF 10 MILLION YEN. DOMESTIC COMPANIES, HOWEVER, MAY BE REQUIRED TO MAKE SPECIAL DEPOSITS IN AN AMOUNT TO BE DECIDED BY THE FINANCE MINISTRY. HOWEVER, IT IS UNDERSTOOD FEW, IF ANY, LOCAL COMPANIES ARE REQUIRED TO PUT UP ANY SPECIAL DEPOSITS. APPLICATION PROCEDURES ARE OFTEN EXCESSIVELY COMPLEX AND PROTRACTED. THIS IS ESPECIALLY THE CASE WHERE A FOREIGN OWNED DOMESTIC LIFE INSURANCE COMPANY IS TO BE FORMED AND LICENSED.
INSURANCE	02	OBLIGATORY OR FORCED USE OF NATIONAL FIRMS FOR SERVICE PROCUREMENT	JAPAN	NO PERSON CAN AID IN TRANSACTING INSURANCE BUSINESS WITH OR ON BEHALF OF FOREIGN INSURERS NOT LICENSED IN THE COUNTRY. ANY FOREIGN INSURER WHO IS NOT LICENSED CANNOT CONCLUDE ANY INSURANCE CONTRACT UPON A PERSON RESIDING IN THE COUNTRY OR PROPERTY LOCATED THE COUNTRY OR SHIPS OR AIRCRAFT OF LOCAL NATIONALITY. PERSONS WISHING TO PLACE INSURANCE DIRECTLY WITH NON-LICENSED FOREIGN INSURERS MUST HAVE APPROVAL FROM GOVERNMENT.

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INSURANCE	03	RESTRICTION WHICH PROHIBITS FOREIGN SERVICE FIRM FROM OFFERING FULL LINE OF SERVICES PROCEDURAL DELAY IN GRANTING FOREIGN SERVICE FIRM LICENSES TO OPERATE	JAPAN	IT IS VERY DIFFICULT FOR FOREIGN INSURANCE COMPANIES TO OBTAIN A LICENSE ESPECIALLY IN THE AREA OF NEW PRODUCTS. THE JAPANESE GOVERNMENT WILL ADMINISTRA- TIVELY DELAY APPROVAL OF A REQUEST FOR AN EXPANDED LICENSE AS LONG AS POSSIBLE OR UNTIL THERE IS A DESPERATE NEED FOR SUCH A PRODUCT.
INSURANCE	02	DENIAL OF ACCESS TO MARKET BY PROHIBITIONS UPON "IMPORTATION" OF A SERVICE FROM OUTSIDE THE COUNTRY OF REFERENCE, EXCEPT UNDER LIMITED CIRCUMSTANCES OR CONDITIONS	JAPAN	PERSONS WHO SEEK TO APPLY TO A FOREIGN INSURER MUST FIRST OBTAIN PERMISSION THEREFORE FROM THE MINISTER OF FINANCE. PERMISSION IS SELDOM OBTAINED DUE TO THE FOLLOWING PROVISIONS: (1A) WHERE SUCH CONTRACTS ARE IN CONTRAVENTION OF ANY LAW (B) WHERE CONTRACTS MAY BE EASILY CONCLUDED ON EQUAL OR MORE FAVORABLE TERMS. (C) WHERE THE CONDITIONS OF CONTRACTS MAY BE EXCESSIVELY DISPROPOR- TIONATE IN COMPARISON WITH THOSE CONDITIONS USUALLY ADOPTED FOR LICENSED INSURERS. (CONTINUED ON NEXT PAGE)

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INSURANCE	02	DENIAL OF ACCESS TO MARKET BY PROHIBITIONS UPON "IMPORTATION" OF A SERVICE FROM OUTSIDE THE COUNTRY OF REFERENCE, EXCEPT UNDER CERTAIN LIMITED CIRCUMSTANCES OR CONDITIONS	JAPAN	(D) WHERE THE INTEREST OF INSURED AND OTHER PERSONS CONCERNED THEREWITH MAY BE IMPROPERLY OR UNJUSTLY PREDJUDICED BY CONCLUDING CONTRACTS (E) WHERE CONTRACTS ARE DEEMED LIKELY TO ADVERSELY AFFECT THE SOUND DEVELOPMENT OF THE INSURANCE BUSINESS IN JAPAN, OR TO IMPAIR PUBLIC INTERESTS. (CONTINUED ON FOLLOWING PAGE)
INSURANCE	02	DENIAL OF ACCESS TO MARKET BY PROHIBITIONS UPON "IMPORTATION" OF A SERVICE FROM OUTSIDE THE COUNTRY OF REFERENCE, EXCEPT UNDER CERTAIN LIMITED CIRCUMSTANCES OR CONDITIONS	JAPAN	(2) THE PREMIUMS CAN BE DEDUCTED FOR TAX PURPOSES, AS A BUSINESS EXPENSE, IF PERMISSION IS OBTAINED. (3) THE PREMIUM MAY BE REMITTED IN US $ BY THE INSURED IF PERMISSION HAS BEEN OBTAINED. (4) THE FOREIGN HEAD OFFICE MAY NOT PAY THE PREMIUM OUT OF US OWN FUNDS, IF THE CORRESPONDING DOCUMENTS ARE NOT AVAILABLE TO SUPPORT IT AS A BRANCH EXPENSE, BECAUSE SUCH PROCEDURE WILL CONFLICT WITH EXISTING EXCHANGE CONTROL REGULATIONS. (CONTINUED ON FOLLOWING PAGE)

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INSURANCE	02	DENIAL OF ACCESS TO MARKET BY PROHIBITIONS UPON "IMPORTATION" OF A SERVICE FROM OUTSIDE THE COUNTRY OF REFERENCE, EXCEPT UNDER CERTAIN LIMITED CIRCUMSTANCES OR CONDITIONS	JAPAN	(5) PROCEEDS OF LOSS PAYMENTS IN US $ MUST BE SURRENDERED TO LOCAL CURRENCY CONTROL AUTHORITIES (A) NON-ADMITTED INSURANCE IS PROHIBITED UNLESS CONTRACTED (B) PERSONS VIOLATING THE PROVISIONS ARE LIABLE TO A FINE OF NOT MORE THAN Y100,000, AND VIOLATIONS COMMITTED BY FOREIGN INSURERS IS A PENALTY OF 3 YEARS AND/OR A FINE OF Y 300,000. SUCH PUNISHMENT APPLIES TO DOING INSURANCE BUSINESS IN JAPAN WITHOUT GETTING THE LICENSE, SOLICITING INSURANCE ON BEHALF OF SUCH NON-LICENSED FOREIGN INSURER AND NOT COMPLYING WITH THE YEN ASSETS REQUIREMENT.
INSURANCE	02	FAILURE TO EXTEND NATIONAL TREATMENT TO FOREIGN SERVICE FIRMS	JAPAN	THE MINIMUM STATUTORY DEPOSIT REQUIREMENT FOR FOREIGN INSURERS IS Y 10,000,000; NONE OF THE JAPANESE COMPANIES ARE REQUIRED TO PUT UP THIS RESERVE.
INSURANCE	02	PROCEDURES OR REQUIREMENTS BIASED AGAINST FOREIGN SERVICE FIRMS	JAPAN	A NONRESIDENT INSURER MAY NOT BE LEGALLY RECOGNIZED AS AN AGENT WITH RESPECT TO INSURED RISKS IN JAPAN.
INSURANCE	08	PROCEDURES OR REQUIREMENTS BIASED AGAINST FOREIGN SERVICE FIRMS	JAPAN	THE COMPLEXITIES AND LENGTHY ADMINISTRATIVE PROCEDURES FOR APPROVALS APPEAR TO BE DISCRIMINATORY IMPEDIMENTS TO FOREIGN-RUN OPERATIONS IN JAPAN.

INDUSTRY	DESCRIPTION OF ACTION	SUPPLEMENTAL DETAILS	COUNTRY	COUNTRY DETAIL
INSURANCE	05	DISCRIMINATION IN FAVOR OF LOCAL FIRMS IN AWARDING OF COMPETITIVE CONTRACTS	JAPAN	THERE IS NO LAW DICTATING HOW GOVERNMENT INSURANCE SHOULD BE PLACED. BUT IT IS MARKET PRACTICE TO PLACE WITH JAPANESE INSURANCE COMPANIES
LEGAL SERVICES	02	RESTRICTIONS WHICH PROHIBIT FOREIGN PROFESSIONALS FROM OFFERING FULL LINE OF SERVICES	JAPAN	AMERICAN LEGAL PRACTICE IS SERIOUSLY IMPEDED AND COMPLICATED BY THE LEGAL AMBIGUITIES OF WHAT ACTIVITIES MAY BE PROPERLY CONSIDERED AUTHORIZED LEGAL PRACTICE BY A FOREIGN ATTORNEY. SOME LAWS WOULD APPEAR TO GIVE FOREIGN ATTORNEYS WIDE SCOPE OF ACTIVITY. OTHERS WOULD APPEAR TO RESTRICT HIS PRACTICE TO THAT RELATING TO A FOREIGN NATIONAL OR LAWS OF FOREIGN COUNTRIES.
MOTION PICTURES	02	SCREEN QUOTA FOR SHOWING LOCAL FILM OR TV PROGRAMS	JAPAN	
TRANSPORTATION AIR	04	CARGO TARIFF DISCOUNTING OR REBATING WHICH FAVORS THE NATIONAL CARRIER	JAPAN	
TRANSPORTATION AIR	06	GOVERNMENT FINANCIAL ASSISTANCE TO THE NATIONAL CARRIER	JAPAN	
TRANSPORTATION AIR	02	MONOPOLY GROUND HANDLING SERVICES GRANTED TO NATIONAL CARRIER, ITS SUBSIDIARY OR OTHER GOVERNMENT OWNED AGENCY	JAPAN	

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TRANSPORTATION AIR	16	MARKETING AND SALES PRACTICES THAT FAVOR DOMESTIC ENTERPRISES E.G. USE OF ILLEGITIMATE INCENTIVES SUCH AS DISCOUNTS, OVERRIDES, REBATES, COMMISSIONS, CARRIERS EXERCISE CONTROL, DIRECT OR OTHERWISE, OVER PORTIONS OF TRANSPORT MARKETING AND SALES STRUCTURES, INCLUDING TOURISM SERVICES AND FREIGHT FORWARDERS, PRIOR ACCESS TO SOURCES OF SALES	JAPAN	THE INTERNATIONAL CARRIER HAS A FINANCIAL INTEREST IN THE LARGEST TRAVEL AGENCY IN JAPAN, AND CONTROLS OTHERS. MANY JAPANESE COMMERCIAL FIRMS APPEAR TO REQUIRE USE OF THE HOMELAND CARRIER. THERE IS ALSO A BUILT IN DISPOSITION BY TRAVEL AGENTS, FREIGHT SALES AGENCIES, AND FREIGHT FORWARDERS TO DIRECT TRAFFIC TO THE INTERNATIONAL CARRIER.
TRANSPORTATION AIR	16	MARKETING AND SALES PRACTICES THAT FAVOR DOMESTIC ENTERPRISES E.G. USE OF ILLEGITIMATE INCENTIVES SUCH AS DISCOUNTS, OVERRIDES, REBATES, COMMISSIONS, CARRIERS EXERCISE CONTROL, DIRECT OR OTHERWISE, OVER PORTIONS OF TRANSPORT MARKETING AND SALES STRUCTURES, INCLUDING TOURISM SERVICES AND FREIGHT FORWARDERS, PRIOR ACCESS TO SOURCES OF SALES	JAPAN	THE CARRIER HAS BEEN INVOLVED IN PAYMENT OF OVERRIDE COMMISSIONS AND DISCOUNTING AND REBATING ACTIVITIES.

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TRANSPORTATION AIR	16	MARKETING AND SALES PRACTICES THAT FAVOR DOMESTIC ENTERPRISES E.G. USE OF ILLEGITIMATE INCENTIVES SUCH AS DISCOUNTS, OVERRIDES, REBATES, COMMISSIONS, CARRIERS EXERCISE CONTROL, DIRECT OR OTHERWISE, OVER PORTIONS OF TRANSPORT MARKETING AND SALES STRUCTURES, INCLUDING TOURISM SERVICES AND FREIGHT FORWARDERS, PRIOR ACCESS TO SOURCES OF SALES	JAPAN	PASSENGERS CONNECTING FROM THE CARRIERS DOMESTIC FLIGHTS TO ITS INTERNATIONAL FLIGHTS ARE GIVEN REDUCED RATES ON THE DOMESTIC PORTION OF THE TRIP. ALSO, SUCH PASSENGERS ARE GIVEN SPECIAL BAGGAGE HANDLING SERVICE
TRANSPORTATION AIR	02	NATIONAL CARRIER ACCORDED PREFERENCE IN AIRPORT FACILITIES AND SERVICES	JAPAN	THE INTERNATIONAL AIR CARRIER OWNS OR PARTIALLY CONTROLS VARIOUS SUPPORT ENTERPRISES I.E. EXCLUSIVE BAGGAGE HANDLER AT TOKYO INTERNATIONAL AIRPORT, AND FLIGHT CARRIERS
TRANSPORTATION MARITIME	07	GOVERNMENT IMPOSED RULES PROHIBIT THE USE OF CERTAIN CONTAINERS	JAPAN	GOVERNMENT RESTRICTS THE USE OF "HIGH CUBE" CONTAINERS EVEN THOUGH CONTAINER AND CHASSIS HEIGHT IS NO GREATER THAN STANDARD CONTAINER ON A FLAT BED TRUCK